IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 1196

IN THE MATTER

of

PRUDENCE-BONDS CORPORATION,

Debtor.

IN THE MATTER

of

The Judicial Settlement of the Account of Proceedings of MANUFACTURERS TRUST COMPANY, as Successor Trustee of Prudence-Bonds, Twelfth Series, under Trust Agreement dated February 1, 1928, between Prudence-Bonds Corporation and Chatham Phenix National Bank and Trust Company, as Trustee.

MANUFACTURERS TRUST COMPANY,

Petitioner,

against

CHARLES H. KELBY and CLIFFORD S. KELSEY,
Trustees of the Debtor;
PRUDENCE-BONDS CORPORATION
(New Corporation);
MARY KEANE, et al.;
GEORGE E. EDDY and
PRUDENCE SECURITIES ADVISORY GROUP.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

CHARLES E. HUGHES, JR.,
DAVID BARNETT,
CURTISS ELY FRANK,
Counsel for Petitioner.

INDEX

SUBJECT INDEX

CASES CITED

PAGE

OTHER AUTHORITIES CITED

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Supreme Court of the United States:

Manufacturers Trust Company, Petitioner, prays that a writ of certiorari issue to review the decree (R. 519) of the United States Circuit Court of Appeals for the Second Circuit, made in the above entitled matter on February 24, 1942,

which decree affirmed an order of the United States District Court for the Eastern District of New York, entered September 3, 1941, modifying and revising a report of the Special Master and denying a motion of Manufacturers Trust Company to dismiss objections to its account and for summary judgment approving its account (R. 8-11).

Opinions Below

The opinion of the District Court (R. 500) is not reported.

The opinion of the Circuit Court of Appeals (R. 519) is reported in 125 F. (2d) 650.

The opinion of the Special Master is not reported but is printed in the record (R. 333).

Jurisdiction

The opinion of the Circuit Court of Appeals was rendered February 3, 1942, and the decree and order for the mandate thereon was entered February 24, 1942.

The jurisdiction of this court to review the decision of the Circuit Court of Appeals is invoked under Section 240 (a) of the Judicial Code, as amended by Act of Congress of February 13, 1925 (U. S. Code, Title 28, Section 347).

Questions Presented

1. Whether the Federal court herein has applied New York state decisions governing the standing of security holders to assert claims of the character involved in the objections here presented against corporate fiduciaries.

2. Whether the Federal court herein has applied New York state decisions governing the application of the statute of limitations to claims asserted more than six years after the alleged breaches of trust occurred.

3. Whether the bankruptcy court has jurisdiction over the subject matter of the objections here in question.

Statement

This is a bankruptcy proceeding.

The facts, which are not in dispute in any material respect, are set forth at length in the findings annexed to the Special Master's Report (R. 347-478).

The Debtor, Prudence-Bonds Corporation, and the Guarantor, The Prudence Company, Inc., were organized in 1919 by a common parent. The Debtor was organized under the Business Corporation Law of New York, and the Guarantor, its affiliate, was organized under the Banking Law of that state (R. 347, 452).

Between January 15, 1920 and February 2, 1931 the Debtor entered into eighteen separate but generally similar trust agreements with various corporate trustees, to secure its bonds of different series, including the Twelfth Series here in question (R. 347). In the Twelfth Series, Petitioner was the successor by merger of Chatham Phenix National Bank and Trust Company as trustee (R. 348, 453).

From time to time the Debtor deposited various mortgages, other securities and cash as collateral under the respective trust agreements. Bonds of the different series issuable against the collateral were authenticated from time to time by the various corporate trustees and delivered to the Debtor, which in turn delivered them to the Guarantor for sale to the public with a guarantee of payment of interest when due and of principal within eighteen months after maturity (R. 347-364, 452-453).

The trust agreement, in addition to providing for the deposit of collateral and the issuance of bonds from time to time, reserved to the Debtor extensive powers, characterized by the Special Master as "extraordinary powers" (R. 337), to collect and retain interest on the deposited securities, extend and enforce deposited mortgages in the name of the corporate trustee or otherwise, release portions of the mortgaged premises, collect proceeds of fire insurance, make substitutions of collateral of various classes, collect and remit to the corporate trustee payments of principal on the deposited

mortgages, pay bonds and surrender them for cancellation, and withdraw so-called "excess collateral" arising through such transactions (R. 337, 29-30, 33-37, 50). Under the agreement there was almost total absence of power on the part of the trustee prior to a default (R. 29-36), with the result that, until default, it was, as we submit, in substance no more than a depositary to hold the pledged collateral.

Interest and principal on all the bonds were paid when due, until 1932, when the Guarantor invoked the above-mentioned eighteen-months clause as to payments of principal (R. 364). Under the indenture (R. 50, 23-24), however, there was no event of default until after the expiration of the eighteen-months period. In 1933, due to the regulations promulgated by the New York State Banking Department following the bank holiday, certain defaults occurred in the payment of interest. See *Pres., etc., of Manhattan Co.* v. *Prudence Co.*, 266 N. Y. 202.

On June 29, 1934 the Debtor, and on February 1, 1935, the Guarantor, filed petitions under Section 77B of the Bankruptcy Act (R. 365). Separate plans of reorganization of the Debtor and of each of the eighteen series of bonds were approved and confirmed by the court (R. 370-371) (*In re Prudence Bonds Corporation (Chemical Bank & Trust Co.*, Appellant), 79 F. (2d) 205 (C. C. A. 2)). The so-called general plan of reorganization provided in part for the formation of a new corporation (hereinafter called the "New Corporation") to succeed to the rights of the Debtor, the bondholders receiving voting trust certificates representing its entire capital stock (R. 377). Each of the so-called separate series plans provided for modification of the bonds, and for the appointment of a successor trustee under a modified trust agreement (R. 151, 379-385). It is undisputed that all property then held by the various corporate trustees, including Petitioner, was turned over to the successor trustee (R. 290-292).

By order of April 27, 1938 all of the corporate trustees were directed to file accounts of all of their proceedings as trustees under the various trust agreements (R. 380-384),

and the accounts were filed in August and September 1938 (R. 403).

The jurisdiction of the District Court to settle the accounts of the corporate trustees in respect to transactions prior to the institution of the 77B proceedings was challenged (R. 414-415) by the Prudence Securities Advisory Group, a bondholders committee which had intervened herein and which is hereinafter sometimes referred to as the "Advisory Group". The District Court held that it had no jurisdiction (R. 420-421, 161-162). On appeal the Circuit Court of Appeals reversed (*Central Hanover Bank & Trust Co., et al.* v. *President and Directors of Manhattan Co., et al.*, 105 F. (2d) 130; R. 424).

On October 2, 1939, objections were filed to the accounts in all except one of the eighteen series by the trustees of the Debtor and by the New Corporation, on their own behalf and on behalf of all of the bondholders, and in some of the series by certain bondholders on behalf of themselves and other holders of bonds (R. 427, 439).

In the Twelfth Series here at issue the objections of the trustees of the Debtor and the New Corporation (R. 106-125) were as follows:

1. To allowance of credit for withdrawals by the Debtor of collateral aggregating $826,500 in amount, between October 30, 1930 and November 20, 1931, either as excess collateral or on the substitution of other collateral, at a time when some of the other collateral (one or two mortgages in each instance) was in default in payment of principal for more than sixty days (R. 107-108, 117). Section 6 of Article I of the trust agreement provided that the Debtor, when not in default on its bonds, might (1) withdraw any bond and mortgage from the "Trust Fund" and substitute for such withdrawn security any other bond and mortgage of equal face value, and (2) might withdraw any collateral in the "Trust Fund" to the extent that the principal amount of the trust fund (*face* amount of bonds and mortgages) exceeded the par value of outstanding Prudence-Bonds,

"provided, that if any securities deposited in the Trust Fund enumerated in [certain paragraphs] shall be in default in the payment of principal for more than 60 days the Corporation shall be permitted to withdraw only such securities deposited under said paragraphs * * * as shall be so in default, * * *" (R. 34-35).

2. To allowance of credit for withdrawals by the Debtor of cash aggregating almost $1,000,000 between August 30, 1929 and November 17, 1931, as excess collateral at times when some of the collateral in the trust fund (one or two mortgages in each instance) was in default in payment of principal for more than sixty days (R. 108-109, 118-120).*

3. To allowance of credit for the cancellation of $229,100 principal amount of bonds delivered by the Debtor to the Trustee in lieu of cash collected by the Debtor on account of bonds and mortgages in the trust fund, between September 12, 1932 and January 28, 1933, when certain collateral was in default and when there had been a failure to pay principal of outstanding bonds, although the eighteen-months period was still running (R. 110-112). Section 1(h) of Article III of the trust agreement provided that the Debtor should monthly pay or deliver to the trustee, to be held as part of the "Trust Fund", cash or liquid securities (together with a statement of collections) "equal to the aggregate of all amounts collected or applied on account of principal of any securities in the Trust Fund during the preceding calendar month". It was provided, however, that "The

*As cash accumulated in the trust fund as a result of the amortization of mortgages the Debtor found it necessary to withdraw such cash in order to keep it invested at 6% interest. In order to withdraw the cash the Debtor deposited additional mortgages thus creating sufficient excess collateral to permit the withdrawal of the cash (R. 96, 91, 94, 100-104, see Special Master's Report, R. 456-459). The success of the Debtor's business depended upon its ability to keep cash invested at 6% interest since most of the bonds carried interest at 5½% and the Debtor's and Guarantor's profit had to be derived from the differential of ½ of 1% (R. 100-102, 362). When mortgages were withdrawn they were accompanied by temporary substitutions of other mortgages or cash (R. 107, 93, 96, 91, 94, 99, see R. 457).

Corporation may deliver to the Trustee [for cancellation] in lieu of the payment or delivery of cash or securities or any part thereof required by this paragraph, an equal face principal amount of Prudence-Bonds issued hereunder maturing within six months after the date of such statement" (R. 49-50). The third objection asserted that almost all of the bonds, whose delivery for cancellation was objected to, had matured on February 1, 1932, and not within six months after the respective dates of the statement accompanying their delivery (R. 110).

4. To allowance of credit for the withdrawal of a mortgage of $65,000 on February 27, 1933, against the cancellation of bonds of a like amount which matured February 1, 1932, when other collateral was in default and when there had been a failure to pay principal of outstanding bonds although the eighteen-months period was still running (R. 113-115).

The objections in the Twelfth Series by bondholders, so far as they are specific, were substantially similar to those of Trustees of the Debtor, and the New Corporation (R. 126-131). The Advisory Group adopted and joined in the objections of the trustees of the Debtor and of the New Corporation (R. 132, 439, 456).

In the case of each transaction in which collateral was withdrawn, this collateral was delivered to the Debtor. There is no claim that Petitioner profited, or that it turned over any property of the Debtor to any third party, or that it failed to turn over to its successor trustee any of the property in the trust (R. 107-115; **Vide* p. 461). There is

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*This and similar references are to certain findings of fact contained in the Special Master's Report (R. 452-464). Some of these findings were objected to by objectors (R. 487-495), although there was no conflict with respect to the facts as distinguished from the legal significance to be attributed to such facts. Judge Inch, in modifying the Special Master's Report, "sustained" the "objections and exceptions" of the objectors to such report in a blanket ruling (R. 502). Nevertheless, in an opinion dated August 29, 1941, Judge Inch stated: "It [the court] took the facts as found by the Special Master * * *" (R. 503).

no claim that Petitioner has any property for which it has not accounted (R. 107-115, 290-292; *Vide* 461-464).

All of the transactions objected to took place between August 30, 1929 and February 27, 1933, more than six years before the objections were served and filed (R. 107-113, 336, 460 [item 34]). During the entire period covered by the objections, no event of default on the part of the Debtor had occurred (R. 23-24; *Vide* 460), and the collateral was being serviced by the Guarantor in accordance with the trust agreement (R. 24, 33, 51-52, 306).

On December 6, 1940, Petitioner moved to dismiss the objections and for summary judgment on the grounds: (1) that the objectors had no status to file their objections, and (2) that the objections were barred by the six-year statute of limitations (R. 12-13, 23).

The Special Master, appointed by the District Court (R. 133-137), in his report dated April 17, 1941 (R. 333-346), recommended that Petitioner's motion be granted on the first ground, except with respect to objections filed by bondholders who owned their bonds at the time of the alleged violations of the trust agreement. These he ruled were the only proper parties to object. On the second ground he recommended (R. 344-346) that the motion should be denied for the reason that the twenty-year statute of limitations applied.

The District Court (Judge Inch) held that Petitioner's motion should be denied *in toto* (R. 500-502).

The Circuit Court of Appeals, in affirming the order of the District Court, held that the claims passed to transferees of the bonds, so that a class action could be maintained by some or all of the objectors, and that the recoveries would become part of the trust funds. It also held that no statute of limitations commenced to run until the trustee repudiated the trust to the knowledge of the beneficiaries or invoked the aid of the court to pass its accounts.

Specifications of Errors to be Urged

1. The Circuit Court of Appeals erred in not holding, in accordance with the law of the State of New York, that the

claims involved belong only to individual bondholders who held their bonds at the time of the alleged breaches of trust and were not transferred with the bonds. The objections of the trustees of the Debtor, the New Corporation, the Advisory Group and individual bondholders in so far as they purport to act for all bondholders as a class, should have been dismissed.

2. The Circuit Court of Appeals erred in not holding, in accordance with the law of the State of New York, that the six-year statute of limitations is applicable and bars the claims in question.

3. The Circuit Court of Appeals erred in permitting the bankruptcy court to assume jurisdiction over the subject matter of the objections here in question.

Reasons for Granting the Writ

The conflict which we assert between the decisions of the New York state courts and that of the Circuit Court of Appeals herein will be developed fully in the argument contained in the brief filed with this petition. Such a conflict with respect to questions of the large and general importance of those here involved is not in the public interest, which requires that the questions be finally resolved at the earliest possible time. This court has in numerous instances, and in cases of far less general importance, granted certiorari to review decisions of circuit courts of appeals which appear to be in conflict with applicable state court decisions. *City Company of New York, Inc.* v. *Stern*, 312 U. S. 666; *Chase Securities Corp.* v. *Vogel*, 312 U. S. 666; *Vandenbark* v. *Owens-Illinois Glass Co.*, 311 U. S. 538; *West, et al.* v. *American Telephone and Telegraph Co.*, 311 U. S. 223; *Fidelity Union Trust Co.* v. *Field*, 311 U. S. 169; *Six Companies* v. *Highway Dist.*, 311 U. S. 180.

The surcharge sought in the Twelfth Series, here at bar, alone is approximately $2,000,000 (R. 107-115). The aggre-

gate principal and accrued interest of the eighteen series was approximately $61,000,000 (R. 334, 369). The future proceedings in nearly all of them will be directly affected by the decision in the case at bar. There are approximately 83,000 bonds in the eighteen series, held by approximately 30,000 holders (R. 368). Moreover, this Court may take judicial notice of the fact that there are billions of dollars of bonds issued and outstanding in the hands of the public under indentures with New York corporate trustees. If we are correct in our assertion that the decision below is inconsistent with the law of the New York state courts, the rights of bondholders and the nature of the liability of corporate trustees with respect to matters of the type here in issue depends, at the present time, and until the questions here presented are finally resolved will depend, entirely upon whether action is brought in the state courts of New York or in the Federal Court.

We submit that certiorari should be granted at this stage of the proceedings in this matter, despite the fact that the decree of the Circuit Court of Appeals here sought to be reviewed is of an interlocutory character. See *U. S.* v. *Socony-Vacuum Oil Co.*, 310 U. S. 150; *Forsyth* v. *Hammond*, 166 U. S. 506; *The Prudence Co. Inc.* v. *Fidelity & Deposit Company of Maryland, et al.*, 297 U. S. 198; *Spiller* v. *Atchison, T. & S. F. Ry. Co.*, 253 U. S. 117; *United States* v. *Gulf Ref. Co.*, 268 U. S. 542; *Stringfellow* v. *Atl. Coast Line*, 290 U. S. 322; *Denver* v. *New York Trust Co.*, 229 U. S. 123.

The sustaining of any one of Petitioner's contentions will finally and completely dispose of all further proceedings. To require lengthy, complicated and expensive accountings, which will add nothing bearing on the fundamental points of law now fully presented and which will be utterly fruitless if Petitioner eventually prevails on any one of them, and to require that these proceedings be reviewed by the District Court and then by the United States Circuit Court of Appeals before they can be presented to this Court for adjudication, is wasteful and undesirable. Moreover, if jurisdiction is lacking, numerous practical problems with respect to further proceedings held before a court without jurisdiction,

such as the assessment of costs and expenses and the effect of efforts to stay proceedings in the state courts, will arise.

WHEREFORE, your Petitioner respectfully requests that a writ of certiorari should be granted as prayed.

Dated: April 28, 1942.

MANUFACTURERS TRUST COMPANY,
Petitioner,

By

CHARLES E. HUGHES, JR.,
DAVID BARNETT,
CURTISS ELY FRANK,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

References to the opinions of the court below and the grounds of jurisdiction, as well as a statement of the case and specifications of error to be urged, are contained in the petition and will not here be repeated.

FIRST: Under the law of New York, the claims here asserted for alleged breach of trust belong only to individual holders who held their bonds at the time such breaches of trust occurred. The Circuit Court of Appeals should have followed the state law and dismissed the objections of the trustees of the debtor, the new corporation and the advisory group, and of bondholders purporting to act for all other bondholders.

The Circuit Court of Appeals recognized that, since the question of the ownership of the claims depended upon the

effect of the assignment of the bonds, the New York decisions are authoritative (R. 520). In addition, the indenture was executed by a New York Debtor in New York and required that the trustee be a New York trust company or a national bank authorized to execute trusts in New York (R. 63, 67). Moreover, the application of the statute of limitations, which is governed by New York law, depends upon the nature and ownership of the claims.

We submit therefore that, whether or not New York law must be followed under the doctrine of *Erie R. Co.* v. *Tompkins,* 304 U. S. 64 (see *D'Oench Duhme & Co. Inc.* v. *Federal Deposit Insurance Corp.,* No. 206 October Term 1941, decided March 2, 1942, 86 L. Ed. 642), the court below was correct in holding that New York law governs the rights of the bondholders under this indenture and the question whether an assignment of a bond vests in the assignee the cause of action based on alleged misconduct of the trustee occurring prior to the assignment. See *Thompson* v. *Magnolia Co.,* 309 U. S. 478, 484; *In Re Prudence Co.,* 82 F. (2d) 755, 757 (C. C. A. 2); *In Re 671 Prospect Avenue Holding Corporation,* 105 F. (2d) 960 (C. C. A. 2). If, however, there is any question about this, an additional reason is presented for the granting of certiorari here to determine finally the question whether the federal court should follow the state law on questions of this sort attempted to be litigated in bankruptcy proceedings.

We submit that the court below was clearly wrong in holding that the allowance of the objections filed by the Trustees of the Debtor, the New Corporation, the Advisory Group and bondholders purporting to act on behalf of bondholders who acquired their bonds after the alleged misconduct of the trustee occurred, was consistent with the decisions of the New York state courts.

There were in New York, prior to the depression and the bank holiday of 1933, two large companies and several smaller companies, in addition to the Prudence companies, engaged in the business of selling securities evidencing interests in guaranteed mortgages. *Seventy-fourth Annual Report of the Superintendent of Insurance of the State of*

New York, for the year ended December 31, 1932 to the Legislature (Legislative Document [1933] No. 35); Annual Report of the Superintendent of Banks of the State of New York for the year ending December 31, 1932, to the Governor and to the Legislature (Legislative Document [1933] No. 26). As shown by the New York cases about to be cited, one of these large companies, the New York Title & Mortgage Company, sold mortgage certificates guaranteed by it and issued by it against pools of bonds and mortgages deposited under depositary agreements with a predecessor of The Manhattan Company. The other large company, Title Guarantee and Trust Company, sold certificates guaranteed by its affiliate, Bond and Mortgage Guarantee Company, and issued for the most part against single bonds and mortgages held by Title Guarantee and Trust Company as depositary and agent under an arrangement set forth in the certificates. Both the New York Title & Mortgage Company and Bond and Mortgage Guarantee Company were taken over for rehabilitation and liquidation by the New York Insurance Department and, as a result, the litigation involving certificates guaranteed by them has been chiefly determined in the state courts. *Jacoby* v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420, cert. den. 293 U. S. 619; *Tolfree* v. *New York Title & Mortgage Co.*, 72 F. (2d) 702, cert. den. 293 U. S. 619; *Depen* v. *Lawyers' Title & Guaranty Company*, 72 F. (2d) 705, cert. den. 293 U. S. 619. It was only because the Debtor here, Prudence-Bonds Corporation, obligor on the bonds, was not a banking or insurance corporation but a business corporation, properly subject to reorganization under Section 77B, that litigation involving the Prudence bonds has happened to be in the federal courts.

In the litigation affecting New York Title & Mortgage Company and Title Guarantee and Trust Company certificates, the New York courts have consistently held, exactly opposite from the holding of the Circuit Court of Appeals in this case, that claims by certificate holders against the depositary or agent for permitting improper withdrawals, releases or substitutions of collateral were not class claims but were individual claims owned by the certificate holders

who held their certificates at the time of the alleged misconduct.

In the first of these cases to reach the Court of Appeals, *Mittlemann* v. *President, etc., of Manhattan Co.*, 248 App. Div. 79 (1st Dept.), aff'd 272 N. Y. 632, trustees appointed under the Schackno Act (L. 1933, c. 745, as amended) in the reorganization of Series Q, New York Title & Mortgage Company alleged that the depositary of the bonds and mortgages securing the certificates of that series breached the deposit agreement in various ways; among others, by accepting mortgages accompanied by no appraisal and no sworn certificate of appraisal, by accepting mortgages which were not valid first liens, by releasing from the deposit good bonds and mortgages and accepting in substitution therefor inferior bonds and mortgages, many of which were apparently not accompanied by appraisals or sworn appraisals (Record on Appeal, pp. 115-116, 118-119, 215, 219-220).

Briefs, several hundred pages in length, were submitted by eminent counsel, including counsel for many Schackno trustees as *amici curiae*. Plaintiffs contended that the reorganization plan promulgated under the Schackno Act and the court order approving the plan, both of which provided that "all of the title, rights, interests and powers of the [certificate] holders * * * in and to the property which now constitutes* *or rightfully should constitute the security* against which such * * * certificates have been issued, including * * * the rights of the holders * * * to enforce the liabilities * * * of the New York Title & Mortgage Company *and any other persons, firms or corporations,* shall immediately be transferred to and vest in the Trustees and their successors" (Record on Appeal, pp. 140, 124), conferred upon the Schackno trustees the power to bring suit on behalf of all certificate holders for such breach of trust. The reorganization declaration of trust provided that the Schackno trustees were vested with the right to enforce "any and all rights and claims which the Certificate-holders * * * *as a class* may

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*All italics in quotations in this brief are supplied unless otherwise noted.

have * * * against any * * * corporation" (Record on Appeal, p. 163).

The Appellate Division, reversing Special Term, and granting a motion to dismiss the complaint, said (248 App. Div. p. 81):

> "The Schackno Act was never intended to result in granting to Schackno trustees the right to bring causes of action asserting the alleged tort claims of the individual certificate holders based on the claimed violation at various times of duties allegedly owed to each of them individually under the contract of the mortgage company and the depositary.
>
> "The causes of action sued on are not causes of action which the series Q certificate holders have 'as a class'. They are individual claims or choses in action."

The Court of Appeals unanimously affirmed without opinion (272 N. Y. 632).

Thereafter, a similar suit was brought by the trustees of Series C-2 of New York Title & Mortgage Company for misconduct of substantially the same sort alleged in the *Mittlemann* case (*Weil* v. *President, etc., of Manhattan Co.*, 275 N. Y. 238). The Court of Appeals was urged to re-examine its decision in the *Mittlemann* case (275 N. Y., p. 242) and granted permission to appeal from the unanimous affirmance by the Appellate Division of the judgment of the Special Term dismissing the complaint. Plaintiffs stressed that there were 25,000 certificate holders in the various issues of the company who, it was argued, would not be adequately protected unless class suits by the Schackno trustees were held to lie (Plaintiffs' main brief, p. 16). The Court of Appeals, reaffirming its holding in the *Mittlemann* case, said (pp. 242-243):

> "The causes of action alleged in the complaint are not of that nature [*i.e.* not held by the certificate holders 'as a class'] *because the interest of each certificate holder depends upon the time and circumstances under which he became a certificate holder.* Some have no possible cause of action and some of the causes of

> action alleged *vested in previous certificate holders who have transferred their certificates.* The rights of those who may have causes of action vary."

The rule that causes of action such as that involved in the instant case are limited to holders who owned their bonds or certificates at the time of the alleged breaches of fiduciary duty is even more strikingly evidenced by the litigation against the Title Guarantee and Trust Company.

Hendry v. *Title Guarantee & Trust Co.*, 255 App. Div. 497 (1st Dept.) was not a suit by Schackno trustees but was an action for an accounting by holders of certificates suing for themselves and for others similarly situated. The Trust Company, which held legal title to the underlying mortgage as agent and depositary had improperly released a condemnation award to the property owner, thus reducing the security without the knowledge of the certificate holders. The Special Term had held (165 Misc. 349) that the defendant was liable to all of the plaintiffs. Three of the plaintiffs, however, had acquired their certificates after the defendant's improper release of the security, two of them by purchase from the defendant, and the third by inheritance from her sister. The Appellate Division held that these three plaintiffs were not entitled to share in the recovery, saying (255 App. Div. p. 500):

> "When Buse and Germond purchased their certificates they acquired only a participation in the mortgage as it existed at that time. The plaintiff MacLean acquired by inheritance only the certificate, not her sister's then existing cause of action for the depreciation in value resulting from the act of the defendant in releasing the security. The cause of action for that breach of trust did not pass from hand to hand with the certificate. (Compare *Weil* v. *President and Directors of Manhattan Co.*, 275 N. Y. 238). We think the rule applied in *Hanna* v. *Florence Iron Co.*, (222 N. Y. 290), and in *Schaffer* v. *Vandewater & Co. Ltd.* (160 App. Div. 803), that the assignment of a contract does not include a right of action for a previous breach, is also applicable here."

In *Horwitz* v. *Title Guarantee and Trust Company*, 259 App. Div. 815 (1st Dept.) the court unanimously affirmed without opinion an order of the Special Term dismissing a complaint of a Schackno trustee which, as appears from the record on appeal, sought recovery for breaches of duty in failing to collect installments of mortgage principal. As appears from the briefs in that case the plaintiff attempted to distinguish the *Mittlemann* and *Weil* cases on the ground that the action was one for maladministration of the mortgage *res. Matter of Mortgage Commission (Lido Club Hotel)* 261 App. Div. 840 (2nd Dept.) affirmed without opinion instructions to Schackno trustees to refrain from prosecuting an action against Title Guarantee and Trust Company predicated, as appears from the record on appeal, upon similar alleged breaches of trust.

The Circuit Court of Appeals' treatment of the above New York decisions, and of others which Petitioner cited below, is, we submit, wholly unsatisfactory. It consists of an attempt to dispose of each case on different factual distinctions and ignoring the total impact of the evidence of the New York law which is inherent in the line of cases as a whole.

Thus the Court below (125 F. (2) 652) said of the *Mittlemann* and *Weil* cases, *supra*, that all that the court actually held was "that the plaintiffs who were 'Schackno trustees' did not succeed to the rights of the bondholders against the defendants". But, as we have shown above, the chief reason on which the New York Court of Appeals held that claims based upon the same kinds of wrong as are involved here did not pass to the Schackno trustees was that they were not held by the certificate holders "as a class" but were individual causes of action the validity of which depended upon the time and circumstances under which the claimants respectively became certificate holders. Moreover, the New York decisions involving New York Title & Mortgage Company certificates were not confined to those in which the plaintiffs were Schackno trustees. In *Hetner* v. *President and Directors of The Manhattan Company*, 251 App. Div. 718 (1st Dept.), the Appellate Division held, as appears in the Record on Appeal, that an action brought by certificate holders

"suing individually and on behalf of all others similarly situated" against the depositary was improperly brought as a class action under Section 195 of the New York Civil Practice Act, but permitted an amendment of the complaint to allow plaintiffs to plead individual causes of action which could be joined under Section 209 of the New York Civil Practice Act. And in *Frank* v. *President & Directors of Manhattan Co.*, 168 Misc. 741 (Spec. T., N. Y. County) where certificate holders endeavored to bring a representative action against the depositary, the court, in dismissing the complaint, said (p. 742):

> "The alleged wrongs might affect the several certificate holders in different degrees, *depending upon whether they were holders at the time one or more of the wrongs were committed.*"

Furthermore, the *Hendry* case, *supra,* was not brought by Schackno trustees but by certificate holders. There the Special Term had held with respect to the three plaintiffs who had acquired their certificates after the alleged wrongs (165 Misc. p. 354):

> "With the acquisition of the certificates by these three plaintiffs went all the rights and privileges and obligations inherent in and which attached to the certificates. I hold that these three plaintiffs are entitled to share in the recovery. (*Pollitz* v. *Gould,* 202 N. Y. 11.)

This was the holding which, as above shown, the Appellate Division unanimously reversed.

The court below then goes on to its second ground of distinction (125 F. (2) 652) which was that "the defendant, which was merely a custodian of the documents, was not like a trustee". This distinction the Court urged not only with respect to the *Mittlemann* and *Weil* cases and other cases involving New York Title & Mortgage Company certificates but to the *Hendry* case involving Title Guarantee and Trust Company certificates.

Whether or not this attempted distinction has any legal validity* it had no part in the *ratio decidendi* of the cases

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*It is submitted that there is no valid distinction between the legal relationships involved in the New York Title & Mortgage Company, the Title Guarantee and Trust Company and the Prudence-Bonds instruments, respectively. The depositary agreement of the New York Title & Mortgage Company provided in detail that that company was under positive duty to deposit with the Manhattan Company mortgages accompanied by sworn appraisals of adequate value and the right of withdrawal and substitution was dependent upon such appraisals. The Manhattan Company was a party to that agreement and the certificates authenticated by it incorporated the terms of the agreement. The certificates issued by the Title Guarantee and Trust Company and signed by it placed positive duties upon and powers in it providing in part that: "The Company * * * shall continue to hold said bond and mortgage * * * for the benefit of the purchaser and any other persons interested therein. * * * The Company shall have full power to take any action it may deem necessary or desirable in order to enforce any of the provisions of the said bond and mortgage and to protect the mortgage security". *Title Guarantee & Trust Company* v. *Mortgage Commission*, 273 N. Y. 415, 419. These duties of the so-called "depositary" and "agent" were at least as strong as those of Petitioner here with respect to the Prudence Bonds. In the case of the Prudence Bonds, Petitioner as trustee apparently had no positive contractual powers or duties with respect to the underlying collateral before default (See *Rhinelander* v. *Farmers' Loan & Trust Co.*, 172 N. Y. 519, 536) whereas the Title Guarantee and Trust Company had at all times full control over the underlying bond and mortgage. The mere appellation of "trustee" is without legal significance. In *Hazzard* v. *Chase National Bank of New York*, 159 Misc. 57, aff'd without opinion in 257 App. Div. 950, and 282 N. Y. 652, cert. den. 311 U. S. 708, Justice Rosenman said: "In such [corporate trust] indentures the use of the word 'trustee' is clearly a misnomer. The corporate trustee has very little in common with the ordinary trustee, as we generally understand the fiduciary relationship. * * * His status is more that of a stakeholder than one of a trustee" (159 Misc. 83-84). (See also *Meisel* v. *Central Trust Co.*, 179 App. Div. 795, aff'd 223 N. Y. 589; *Matter of Accounting of Neilley*, 95 N. Y. 382; *Matter of Ihmsen*, 253 App. Div. 472.) The fact that the Petitioner may hold legal title is immaterial. The Title Guarantee and Trust Company specifically held legal title to the mortgages there involved. *E. T. C. Corp.* v. *Title Guarantee & Trust Co.*, 271 N. Y. 124, 130. In the case of Prudence Bonds there was a pledge by the Debtor, and normally legal title remains in the pledgor. There was at least sufficient legal title in the Debtor to permit its reorganization under Section 77B and whatever title the Petitioner held as trustee was merely a security title. (*In re Prudence-Bonds Corporation*, 77 F. (2d) 328, 330; cert. den. 296 U. S. 584; *In re Prudence Bonds Corporation* v. *Chemical Bank & Trust Co.*, 79 F. (2d) 205 (C. C. A. 2); *In re Prudence Bonds Corporation*, 79 F. (2d) 212, 217.)

sought to be thus distinguished. Not only was there no discussion of any question whether the defendant was a trustee, or only a depositary or agent, but the opinions contained affirmative evidence that any such question was regarded as without significance. In the *Hendry* case the Special Term said (165 Misc. p. 352):

> "The certificate holders should have been apprised of the situation. In effect, it makes no difference whether the defendant was a trustee in a technical sense or a mere agent. It was a fiduciary, with all that the office imposes and implies. (*Marvin* v. *Brooks*, 94 N. Y. 71, 78.) It owed a duty to the certificate holders, and that duty was not casual or perfunctory."

and the Appellate Division opinion said (255 App. Div. 499):

> "We agree with the Special Term that a *trustee or* agent has no power ordinarily to release any part of the security in his possession no matter how adequate the security remaining may appear."

In *Rabinowitz* v. *President and Directors of The Manhattan Company*, 275 N. Y. 453, a companion case to the *Mittlemann* and *Weil* cases, in which the Court of Appeals affirmed without opinion a judgment dismissing the complaint of Schackno trustees, the statement of the case by the court reporter contains the following sentence:

> "The defendant, at the time this action was commenced, was the trustee and depositary of collateral security for such certificates."

This was of course not a statement by the court but it tends to confirm the indication from the other cases that any such distinction as that suggested by the Circuit Court of Appeals below was not regarded as of any significance.

Conclusive refutation of any supposition that the New York law on this subject makes any distinction between a corporate trusteeship and a depositary or agency relation appears in the case of *Elkind* v. *Chase National Bank*, 259 App. Div. 661, aff'd without opinion 284 N. Y. 726. In that case the defendant was unquestionably a trustee. A bond-

holders' representative action was based on a charge that it, while trustee of the bond issue, obtained payment to itself of certain bank loans through a subsidiary of the obligor on the bonds, which was used to siphon off the profits and good will of the obligor which otherwise would have remained as additional security for the bonds. The Appellate Division held that the good will had not been pledged as part of the mortgage, that the action was simply for breach of trust, and that therefore a bondholders' representative action would not lie. The court stated that only individual bondholders who held their bonds at the time of the alleged breaches of trust could bring suit.

The ground upon which the Circuit Court of Appeals (125 F. (2) 653) below attempted to distinguish this case (the ground that the defendant was not a trustee being plainly unavailable) was that the action was not, as it construed the instant case to be, one to recover a part of the mortgage *res*. The attempted distinction overlooks the fact that other New York cases in the line on which we rely were as much of that character as the case at bar. The court in the *Elkind* case relied strongly (259 App. Div. p. 666) on the *Hendry* case, which, as above pointed out, was an action to recover the amount of a condemnation award wrongfully released by the fiduciary. The Special Term in that case (165 Misc. p. 353) said: "If, as we see, the award supersedes the land, the certificate holders automatically become partners in the award." In most of the cases involving certificates of the New York Title & Mortgage Company, above cited, the alleged breaches of trust included the release of mortgages without adequate substitutions. It is perfectly plain from the opinion in the *Elkind* case that what the court meant by a suit to "recover" the *res* was limited to cases where the corporate trustee had received for its own benefit a part of the property covered by the mortgage. This is plain enough from the language of the court at page 664 of the opinion which the Circuit Court of Appeals below (125 F. (2) 653) itself quotes. But it appears unmistakably from the following extract from the Appellate Division's opinion at page 665:

> "If defendant wrongfully took such money proceeds *for itself,* its breach, if any, was of a fiduciary duty for which it may be held to account in a proper action instituted on behalf of aggrieved individual bondholders, but a bondholders' representative action for an accounting for *damages for breach of trust,* as distinguished from a suit to recover property that was subject to the lien of the mortgage, cannot be maintained by these plaintiffs."

The court cited and relied on the *Hendry, Mittlemann* and *Weil* cases as representing the governing rule. The distinction which the Appellate Division made was manifestly between recovering from the trustee the trust property itself or its misappropriated proceeds, on a theory of constructive trust or otherwise, and a suit for damages to be payable out of the general assets of the defendant.

The combined effect of the *Elkind* case, and the *Hendry, Mittlemann* and *Weil* cases on which it relies, clearly indicate that the law of New York is that such claims belong only to bondholders who held their bonds at the time of the alleged misconduct, whether the defendant be a trustee, or some other kind of fiduciary. The principle, in the language of the court in the *Elkind* case, is that "A trustee cannot, before the relationship is established, have violated a trust duty." (259 App. Div. 666.) See *Doyle* v. *Chatham & Phenix Nat. Bank,* 253 N. Y. 369.

The New York law was so interpreted in a very recent decision by the court of first instance in *Emmerich* v. *Central Hanover Bank & Trust Co.* (Special Term, New York Co., New York Law Journal, March 10, 1942, p. 1040). In that case the defendant was unquestionably a trustee and the cause of action was based upon allegations, among others, that it had improperly permitted a valuable lease and agreement, which was part of the mortgage security, to be cancelled and abrogated. The complaint did not allege that the plaintiff bondholder was such at the time the alleged breaches of trust were committed. The court, relying principally upon the *Elkind* case and the *Hendry* case, dismissed the complaint. We attach a copy of the opinion as an appendix to this brief.

Where state law is to be applied in the federal courts, a decision of a court of first instance may be as persuasive evidence of the state law as that of the highest court, where there is no authority in the appellate courts to the contrary (*Fidelity Trust Co.* v. *Field,* 311 U. S. 169). The *Emmerich* case, above referred to, cannot be distinguished upon any of the grounds suggested by the Circuit Court of Appeals below, and the Circuit Court of Appeals' opinion cites no New York case which is contrary to that decision. In fact it cites no New York decision which has any tendency to support the conclusion which it reached. The best that it could do with the New York authorities was to attempt to pick them off one by one with various differing, and often tenuous factual distinctions. This is not the spirit in which the decisions of this Court require the federal courts to approach the interpretation of the law of the State. In *West* v. *A. T. & T.,* 311 U. S. 223, 237, this Court said:

> "State law is to be applied in the federal as well as the state courts and it is the duty of the former in every case to ascertain *from all the available data* what the state law is and apply it rather than to prescribe a different rule, *however superior it may appear from the viewpoint of 'general law'* and however much the state rule may have departed from prior decisions of the federal courts. See *Erie Railroad Co.* v. *Tompkins, supra,* 78; *Russell* v. *Todd, supra,* 203."

We submit that here the court below did not follow that admonition, and that it is impossible to read the line of New York cases which we have above cited without reaching the conclusion that the New York courts would decide the controversy here involved contrary to the decision below. The court below followed its attempted distinction of the *Elkind* case with an argument on principle, supported only by citations from other jurisdictions and a text-book, designed to indicate that the rule which it announced was "superior" to that which would result from the rule which we submit is established by the New York cases. But all of the alleged

injustices* which the court said would follow from confining a cause of action for surrender of the security to bondholders who were such at the time of the misconduct would apply equally whether the defendant fiduciary were a strict trustee or a "depositary" or "agent".

It is general New York law applying even to accountings by estate and other fiduciaries, that no beneficiary may object to such fiduciary's account except in respect of wrongs which he himself has sustained, and he may seek redress for himself only. *Matter of Garvin,* 256 N. Y. 518, 521; *Matter of Ellensohn,* 258 App. Div. 891 (2nd Dep't); *Matter of Hurewitz,* 174 Misc. 182; *Matter of Stumpp,* 153 Misc. 92; *Matter of Dempsey,* 259 App. Div. 1083 (2nd Dep't); *Matter of Sul-*

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*We submit that at least equal injustice would be attendant upon the rule announced by the Circuit Court of Appeals below. Many of the bondholders who would be permitted to recover under the decision below bought their bonds at low prices during the depression long after the breaches of trust occurred, and allowance of their claims would be at the expense of bondholders who disposed of their bonds at low prices and who under New York law rightfully own the claims (See R. 460; Findings 36, 37). Many of the bonds were not even authenticated until after the alleged breaches of trust occurred (R. 100-102) and so are not entitled to recover (*Doyle* v. *Chatham & Phenix Nat. Bank,* 253 N. Y. 369, *supra*). If the judgment of the Circuit Court of Appeals below stands in favor of all present bondholders, it will be no protection to the petitioner against claims which may be made by those who held the bonds at the time of the alleged breaches of trust, who are not before this court and who will not be bound by the judgment. If the claims are class claims belonging to all present bondholders, the Guarantor which owned $390,500 of Twelfth Series bonds (R. 340) and stockholders, officers and directors of the Guarantor and Debtor who owned many of the bonds (R. 256) will apparently share in any recovery despite the fact that they caused and obtained the benefit of the withdrawals which are the subject of complaint, contrary to New York state law as established in *Butterfield* v. *Cowing,* 112 N. Y. 486. (See also *Matter of Garvin,* 256 N. Y. 518.) Finally, the Prudence plans contemplate that any excess in any particular series, after the complete retirement of the bonds in that series, will become proportionately available to the collateral of all other series (R. 219-220). Therefore, if these claims are considered class claims, bondholders of entirely different series may conceivably obtain the ultimate benefit of any recovery rather than those who, because they held their bonds at the time of the alleged breaches of trust, have suffered any actual damage that may have occurred.

livan, 177 Misc. 570; *Giles Dyeing Machine Co.* v. *Klauder-Weldon D. M. Co.,* 233 N. Y. 470; *Matter of Wechsler,* 173 Misc. 802.

It is unnecessary to consider separately the right of the trustees of the Debtor, the New Corporation and the Advisory Group to file objections to Petitioner's account. Their right to file objections is necessarily derived from the bondholders they purport to represent, and if the claims asserted are individual claims belonging only to those who held bonds at the time of the respective alleged breaches of trust they are not and have not been vested in these three representatives or any of them (R. 341-342, 415-416). *Barnes* v. *Hirsch,* 215 App. Div. 10, aff'd 242 N. Y. 555, cert. den. 273 U. S. 709; *Tannenbaum* v. *Seacoast Trust Co. of Asbury Park, et al.,* 16 N. J. Misc. 234, 198 Atl. 855, 872, aff'd 125 N. J. Eq. 360, 5 A. (2d) 778; *Seeymiller* v. *Day,* 249 Fed. 177 (C. C. A. 7); *Meyer* v. *Lowry & Co., Inc.,* 257 App. Div. 81.

SECOND: Under the law of New York, which the Circuit Court of Appeals should have followed, the six-year statute of limitations is applicable and bars the claims covered by the objections here in question.

It seems to be undisputed that the law of New York should be followed by the federal courts in determining whether or not these objections are barred by the statute of limitations. *Miles* v. *Vivian,* 79 Fed. 848 (C. C. A. 2); *Frismuth* v. *Farmers' Loan & Trust Co.,* 107 Fed. 169, 173 (C. C. A. 2); *Guaranty Trust Co.* v. *U. S.,* 304 U. S. 126, 136-137; *West* v. *A. T. & Co.,* 311 U. S. 223. See *City Company of New York, Inc.* v. *Stern* and *Chase Securities Corp.* v. *Vogel,* 312 U. S. 666.

The Circuit Court of Appeals utterly ignored the decisions of the New York courts relating to the statute of limitations governing claims against corporate trustees predicated upon alleged breaches of fiduciary duties under collateral trust indentures.

The Circuit Court of Appeals held summarily (125 F. (2) 654) that, since the claims here involved were for restitution of the *res* under an express trust, no statute of limitations begins to run "until the trustee has repudiated the trust to the beneficiary's knowledge, or himself invokes the aid of the court to pass his accounts".

For this proposition the court cites a single New York case, *Ludington* v. *Thompson*, 153 N. Y. 499, which is inapposite on its facts. The general rule relating to express trusts to which the New York Court of Appeals adverted by way of *dictum* (153 N. Y., p. 505) is by no means uniform, as the Court itself recognized (153 N. Y., p. 506), and with respect to actions against corporate trustees of collateral trust indentures, the New York law is, we submit, clear that ordinary statutes of limitations are applicable to actions for breach of their fiduciary duties. *Rhinelander* v. *Farmers Loan & Trust Co.*, 172 N. Y. 519; *Frismuth* v. *Farmers Loan & Trust Co.*, 95 Fed. 5, aff'd 107 Fed. 169 (C. C. A. 2).

In those cases bondholders sued the trustee of the same railroad mortgage, alleging that the trustee certified and issued bonds with knowledge that the obligor had not fulfilled the requirements of the indenture as to the purposes for which the proceeds were to be applied and without requiring proper written orders from it. Under the indenture the trustee was to certify and issue bonds only upon orders of the obligor which were to include statements declaring the purpose for which the proceeds of the bonds so ordered were to be appropriated. Neither court entertained any idea that no statute of limitations began to run until repudiation by the trustee. The sole question was what period of limitation, after the accrual of the cause of action, governed. The plaintiffs contended that the trustee had been guilty of breach of an implied covenant in the indenture and hence the twenty-year statute (now Civil Practice Act, Sec. 47) applying to "an action upon a sealed instrument" governed. The Court held, however, that the obligation breached by the trustee was not an implied covenant in the mortgage but "an implied legal duty or obligation springing from the rela-

tion of trustee and *cestui que trust*" (172 N. Y., p. 531). The trustee had signed the instrument (as did the Petitioner in this case) only to accept the trust. Accordingly the twenty-year statute did not apply, and the question whether the applicable period was six years (present Civil Practice Act, Sec. 48) or ten years for "an action, the limitation of which is not specifically prescribed in this article" (present Civil Practice Act, Sec. 53) was not involved since the breaches of trust occurred more than ten years before action was brought. Both those actions were begun in 1899 (172 N. Y., p. 536; 95 Fed. p. 5), and the last breach of trust occurred in 1885 (*id.*, p. 529). The Court's indication in the *Rhinelander* case that the ten-year statute was the applicable one accordingly was *dictum*. In the *Frismuth* case the indications from the Court's statement that the defendant's conduct "may be regarded as a breach of a *quasi* contract or a contract implied in law" (107 Fed., p. 174) and from the attempt to amend the complaint in the companion *Antelo* case (107 Fed., p. 174) are that the Court regarded the six-year statute as applicable. Both cases are square authority against the theory of the Circuit Court of Appeals herein. The bonds secured by the indenture were not due until October 1, 1900 (172 N. Y., p. 523); the trust could therefore on no theory have terminated when the actions were commenced, and it had not been repudiated.

The question as between the six and ten-year statutes was definitely decided in the recent case of *Savings Bank of New London* v. *New York Trust Co.*, 27 N. Y. S. (2d) 963 (Supreme Court, N. Y. County, May 9, 1941), which was also an action by bondholders against the trustee of a railroad mortgage for misconduct. In 1929, the defendant trust company, at the request of the railroad obligor, released from the lien of the mortgage certain stock, bonds, leases and other property, and in 1930 and 1931 certain physical properties which were then sold. The trustee, instead of requiring the proceeds of the sale to be turned over to it, accepted certain bonds covered by the same mortgage, which were held to have been discharged when acquired by the railroad and were

therefore nullities when received by the trustee. The court held that there had not been a violation of any express covenant but rather a breach of an implied duty, and, since an action at law would lie, the six-year statute of limitations was applicable. This case is also authority against the theory of the Circuit Court of Appeals herein because there had apparently been no repudiation of the trust by the trustee.

The decision that the six-year, rather than the ten-year, statute is the one applicable is in accordance with a line of New York cases about to be cited, brought by certificate holders against the Title Guarantee and Trust Company for analogous breaches of fiduciary obligations. These cases are as clearly in point on that question as are cases involving mortgage trustees because, obviously, the question whether the fiduciary is the usual corporate trustee or an agent, depositary or other sort of fiduciary has nothing to do with whether the ten-year or the six-year statute governs. That distinction could be material only on the theory advanced by the Circuit Court of Appeals that the statute does not begin to run against a trustee until repudiation of the trust, which theory, as we have above pointed out, is disposed of by the *Rhinelander* case, *supra*. It is only where a defendant fiduciary is obliged to account for property taken by itself that the ten-year statute may apply. See *Potter* v. *Walker*, 276 N. Y. 15. Actions for breaches of fiduciary duties wholly analogous to those involved in the present case have uniformly been held to be barred by the six-year statute of limitations on the ground that for them actions at law would lie. *Kesner* v. *Title Guarantee & Trust Co.*, 259 App. Div. 597 (1st Dept.) aff'd 284 N. Y. 622 (action based on defendant having extended the underlying mortgage without disclosing to plaintiff that certain portions of the mortgaged premises had been previously released by defendant); *Clark* v. *Title Guarantee & Trust Co.*, 259 App. Div. 136 (1st Dept.), aff'd 284 N. Y. 619 (based on defendant having extended the mortgage without the knowledge or consent of the plaintiff and having improperly failed to collect principal and interest on the bond

and mortgage); **Follender* v. *Title Guarantee and Trust Company,* 258 App. Div. 724 (1st Dept.) (based on defendant having released to the mortgagor a condemnation award, which was part of the mortgage security, without the knowledge or consent of the certificate holders (Record on Appeal, pp. 2-3, 20, 23); **Fichter* v. *Title Guar. & Trust Co.,* New York Law Journal, August 9, 1939, p. 327).

In *Kesner* v. *Title Guarantee and Trust Company, supra,* the Appellate Division, which the Court of Appeals affirmed without opinion, said (259 App. Div. p. 598):

> "Plaintiffs have a complete remedy at law to recover the money damages sought in the complaint. (*Strebler* v. *Title Guarantee & Trust Co.,* 250 App. Div. 846; modfd. in other respects, 277 N. Y. 730). In similar actions for breach by defendant of the duty which it owes as agent to a certificate holder, it has been held that an adequate remedy at law exists to which the six-year Statute of Limitations must be applied. (*Follender* v. *Title Guarantee & Trust Co.,* 258 App. Div. 724; *Clark* v. *Title Guarantee & Trust Co.,* 259 *id.* 136).
>
> Though plaintiffs might maintain an action in equity to recover for constructive fraud, there is, nevertheless, a concurrent adequate remedy at law for damages. The rule is settled that when a legal and an equitable remedy exist as to the same subject-matter,

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*The *Follender* and *Fichter* cases, *supra,* are also direct authority against the applicability of the 20-year statute. In both those cases the plaintiff argued that the suits were upon sealed instruments, namely the certificates, but the courts, specifically citing the *Rhinelander* case, sustained motions to dismiss on the ground that the six-year statute applied. New York Law Journal, October 6, 1938, page 999 and August 9, 1939, page 327. In the former case the opinion of the Special Term, which the Appellate Division affirmed, said:

> "I am unable to perceive that this action is upon a sealed instrument. It stems from the relationship of the parties; it does not rest upon any breach of a covenant. Nor is it a suit upon the certificate (*Rhinelander* v. *Farmers Loan & Trust Co.,* 172 N. Y., 519)."

See also *Trustees of Mission Church* v. *Ridley,* 167 App. Div. 392 (1st Dept.); *Syracuse Savings Bank* v. *Onondaga Silk Co.,* 175 Misc. 811 (Supreme Court, Onondaga County).

the latter is under the control of the same statutory bar as the former. (*Keys* v. *Leopold*, 241 N. Y. 189; *Hanover Fire Ins. Co.* v. *Morse D. D. & R. Co.*, 270 *id.* 86)."

Other cases holding that an action at law lies against a corporate trustee for breach of trust are: *Hunsberger* v. *Guaranty Trust Company*, 164 App. Div. 740 (1st Dept.); *Margulies* v. *Manufacturers Trust Co.*, 148 Misc. 564 (App. Term, 1st Dept.); *Bank of New York* v. *N. J. Title Guar. & Trust Co.*, 256 App. Div. 609 (1st Dept.); *Cf. Kane* v. *Bloodgood*, 7 John Ch. 90, aff'd 8 Cowen 360; *James* v. *Cowing*, 82 N. Y. 449. Even if there is also an equitable remedy, that remedy is governed by the legal statute of limitations. *Kesner* v. *Title Guarantee and Trust Co., supra; Keys* v. *Leopold*, 241 N. Y. 189. And where the six-year statute is applicable, the plaintiff's ignorance of the facts is immaterial. *Scott on Trusts*, Section 219; *Keys* v. *Leopold*, 241 N. Y. 189; *Chance* v. *Guaranty Trust Co. of New York*, 173 Misc. 754, 762, aff'd 257 App. Div. 1006, aff'd 282 N. Y. 656; *Libby* v. *Van Derzee*, 80 App. Div. 494, aff'd 176 N. Y. 591, reargument denied 177 N. Y. 567; *Wechsler* v. *Bowman*, 285 N. Y. 284, 293; *Schmidt* v. *Merchants Despatch Trans. Co.*, 270 N. Y. 287, 300.

THIRD: The bankruptcy court has no jurisdiction over the subject matter of the objections in question.

The Circuit Court of Appeals entertained jurisdiction over the objections here in controversy, following in that connection its decision in *Central Hanover Bank & Trust Company* v. *President and Directors of Manhattan Company*, 105 F. (2d) 130. No application for certiorari was made to review that decision at the time. However, the question of the jurisdiction of the Court over the subject matter of the controversy is open at all times, regardless of the previous attitude of any party thereto, and is one which may be raised by the Court *sua sponte*. *M. C. & L. M. Railway Co.* v. *Swan*,

111 U. S. 379; *Minnesota* v. *Northern Securities Co.*, 194 U. S. 48; *Treinies* v. *Sunshine Min. Co.*, 308 U. S. 66. It is therefore necessary to re-examine the basis of that decision at this time.

If we are right in our first contention that the claims here asserted by the objectors are not class claims, but belong only to those who held their bonds at the time that the alleged breaches of trust occurred, we submit that the absence of bankruptcy jurisdiction is plain. Such individual causes of action are not within even the most latitudinarian conception of the Debtor's property. Not only would any sums recovered from Petitioner not be of property in which the Debtor has or had any interest, but it is not property in which any class of the Debtor's creditors at the time the bankruptcy proceedings were instituted had any interest as such. They are simply causes of action which persons who were once creditors of the Debtor have against a party which has allegedly injured their particular property interests. One of the objectors' own proposed conclusions of law, No. 47, which was refused by the Special Master but ordered found by the District Court (R. 492, 502), stated (R. 325):

> "47. This Court, in these reorganization proceedings, does not have, and has not taken, jurisdiction over personal and individual claims or common law causes of action or choses in action of bondholders or others, for damages, against Manufacturers Trust Company, as Trustee of Prudence-Bonds, Twelfth Series."

But even if the claims were held to be class claims, in which all present bondholders had an equal and ratable interest, jurisdiction in the bankruptcy court would still, we submit, be lacking. They would not be claims that accrued to the Debtor at any time; nor would they be based on any injury done to the Debtor or to its property, or on any damage which it has at any time sustained. Any recovery on such claims would not be of property in which the Debtor has or at any time had any interest. Although the persons in whose favor the claims may have accrued are bondholders

of the Debtor and even assuming that for the purposes of such claims they may be held to constitute a "class"—nevertheless, they are not in respect of such claims creditors of the Debtor, but creditors of their indenture trustee in their own right.

The Circuit Court of Appeals seems to have supposed (105 F. (2d), p. 131) that, but for the fact that the Debtor was "a participant in" and "the instigator of" the alleged breaches of trust, jurisdiction would be clear. All of the examples cited by it for what it calls the "extended meaning of the debtor's property" (p. 132) were of property which should have been a part of the estate of the bankrupt at the time the bankruptcy proceeding was commenced, but which the bankrupt had permitted to go to others, *i.e.*, property which the bankrupt had fraudulently conveyed (Sec. 70(a)(4)), or which had been transferred preferentially (Sec. 60(b)), and property which might be reached by a judgment creditor (Sec. 70(c)). But the participation of the Debtor in the alleged wrong is not the only, or the chief, point of our contention. The point is that the property here in question was property to which, by the claimants' hypothesis, the Debtor was not entitled, but which the Trustees' alleged misconduct permitted to reach the Debtor. Petitioner's conduct which is complained of swelled, not depleted, the Debtor's estate before bankruptcy.

The Circuit Court of Appeals does not assert that trustees in reorganization under Article 10 have greater powers, in this respect at least, than ordinary bankruptcy trustees. It cites Sections 186 and 187 for the point that a reorganization trustee has "all the power of an ordinary trustee" or of a receiver in equity, and its citation of *McCandless* v. *Furlaud*, 296 U. S. 140, and *Pittsburg Carbon Co.* v. *McMillin*, 119 N. Y. 46, is for the point that an equity receiver may have a better standing than the debtor would have. That is but a part of the Court's attack upon the theory that the Debtor's participation in or instigation of the wrong is not a bar to the trustees, which, as we have pointed out, is not the point. Similarly, the Court's theory (p. 132) that the various groups of creditors "constitute a hierarchy of mutually inde-

pendent interests" is irrelevant. The authority of the Trustee to recover property for the benefit of any group in that hierarchy is, we submit, limited to property which was, or should have been, the Debtor's. *McCandless* v. *Furlaud, supra,* which was an extreme application of rules regarding a receiver's standing to sue, was still of the latter category.

We submit that the question thus presented should be determined by this Court. The Circuit Court of Appeals cites no authority for its conclusion which is even analogous on its facts. There is authority, which we submit is analogous, to the contrary, in a line of cases holding that statutory liabilities such as that imposed on directors for the corporation's debts when they have declared dividends while the corporation was insolvent, or in excess of its capital stock, and the statutory liability of stockholders, cannot be enforced by a trustee in bankruptcy, although recovery would have benefited creditors as a class, when under the law of the state they are personal to the creditors. *Seegmiller* v. *Day,* 249 Fed. 177 (C. C. A. 7); *In re Crystal Spring Bottling Co.,* 96 Fed. 945 (D. C., Vt.); *In re Jassoy Co.,* 178 Fed. 515 (C. C. A. 2); *Courtney* v. *Georger,* 228 Fed. 859 (C. C. A. 2), cert. den. 241 U. S. 660; *In re Beachy Co.,* 170 Fed. 825 (D. C., Wis.); *In re Huffman-Salvar Roofing Paint Co.,* 234 Fed. 798 (D. C., Ala.). See *Jacobson* v. *Allen,* 12 Fed. 454.

The present controversy properly belongs, we submit, in the State court having jurisdiction over the indenture trustee, to which such trustee is required to account and the law of which must in any event determine the result.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: New York, April 28, 1942.

CHARLES E. HUGHES, JR.,
DAVID BARNETT,
CURTISS ELY FRANK,
Counsel for Petitioner.

APPENDIX

SUPREME COURT, NEW YORK COUNTY—SPECIAL TERM, PART III

Decided by Mr. Justice Levy, March 9, 1942.
Reported New York Law Journal March 10, 1942, p. 1040

Emmerich v. *Central Hanover Bank & Trust Co.*—This is a motion to dismiss the first, second and third causes of action for alleged insufficiency, and also to dismiss the second and third causes of action on the ground that the statute of limitations has run against them.

Each of the three causes whose sufficiency is assailed fails to state a good cause of action for lack of an allegation that plaintiff was a bondholder at the time of the breaches of trust charged to the defendant. In *Elkind* v. *Chase Nat. Bank* (259 App. Div. 661, aff'd 284 N. Y., 726) the Appellate Division of this department held not only that no representative action was maintainable for injury to the bondholders as a class, but also that the plaintiffs did not even possess individual causes of action (p. 666): "These plaintiffs have not individual causes of action for the alleged breaches of fiduciary duty since it is admitted in the stipulation of facts that they did not purchase their bonds until October, 1936, long after all the breaches alleged in the complaint had occurred. A trustee cannot, before the relationship is established, have violated a trust duty."

In *Hendry* v. *Title Guar. & Trust Co.* (255 App. Div. 497), a similar holding was made as to plaintiffs who held participation certificates in a bond and mortgage. The attempt of plaintiff to distinguish the instant case on the basis of the fact that the bonds here involved are bearer bonds which were to be equally and ratably secured by the trust indenture regardless of time of issue or negotiation is without merit. The provision that all the bonds were to be equally secured has nothing whatsoever to do with the question of whether a bondholder may recover for breaches of trust committed by the trustee at a time when someone else owned the bonds. That provision is the usual one to be found in trust indentures and was undoubedly present in *Elkind* v. *Chase National Bank* (*supra*). Nor may plaintiff

derive any comfort from the fact that a stockholder may maintain a derivative action on behalf of his corporation to recover for wrongs occurring prior to the acquisition of his stock (*Pollitz* v. *Gould*, 202 N. Y. 11). The rationale of the decision in *Pollitz* v. *Gould* (*supra*) was that a derivative stockholder's action is commenced for the benefit of the corporation and not for the individual benefit of the stockholder. The right of action which the stockholder enforces on behalf of the corporation is among the corporate assets in which he acquires an interest by purchasing shares of stock. No such reasoning may be applied to a suit by a bondholder for breaches of trust occurring at a time when he owned no bonds. Conceivably, the person or persons who owned the plaintiff's bonds at the time the breaches of trust were committed may have obtained satisfaction for the breaches or may have waived them. At any rate, this court is constrained by the decision of the Appellate Division in *Elkind* v. *Chase National Bank* (*supra*) to hold that the plaintiff may not recover for breaches of trust committed prior to his acquisition of the bonds now held by him in the absence of an assignment to him of the causes of action for breach of trust. *Matter of 24-54 Forty-fourth Street, Long Island City* (176 Misc. 249) cited by plaintiff, has no application here. That case involved the right of a certificate holder to enforce a guaranty rather than his right to recover for a breach of trust occurring prior to the acquisition of the certificate.

There being no allegation in any of the causes of action that plaintiff was a bondholder at the time the alleged breaches of trust were committed, and there being no averment that the causes of action for breach of trust had been assigned to plaintiff by those who owned the bonds, at the time the breaches were committed, the motion to dismiss the causes of action for insufficiency is granted, with leave to serve an amended complaint within ten days from the service of a copy of this order, with notice of entry. In view of this disposition it becomes unnecessary at this time to decide whether the second and third causes of action are barred by the statute of limitations. The motion is denied, without prejudice to the extent that it seeks the dismissal of those causes of action on the basis of that statute.

Order signed.

(23)

FILED
MAY 20 1942
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 1196

In the Matter of
PRUDENCE-BONDS CORPORATION, *Debtor.*

In Proceedings for Reorganization under Section 77B of the Bankruptcy Act.

In the Matter of the judicial settlement of the account of proceedings of Manufacturers Trust Company, as Successor Trustee of Prudence-Bonds, Twelfth Series, under Trust Agreement dated February 1, 1928, between Prudence-Bonds Corporation and Chatham Phenix National Bank and Trust Company, as Trustee.

MANUFACTURERS TRUST COMPANY, *Petitioner,*
against

CHARLES H. KELSEY and CLIFFORD S. KELSEY, Trustees of the Debtor, PRUDENCE-BONDS CORPORATION (New Corporation), MARY KEANE et al., GEORGE E. EDDY and PRUDENCE SECURITIES ADVISORY GROUP.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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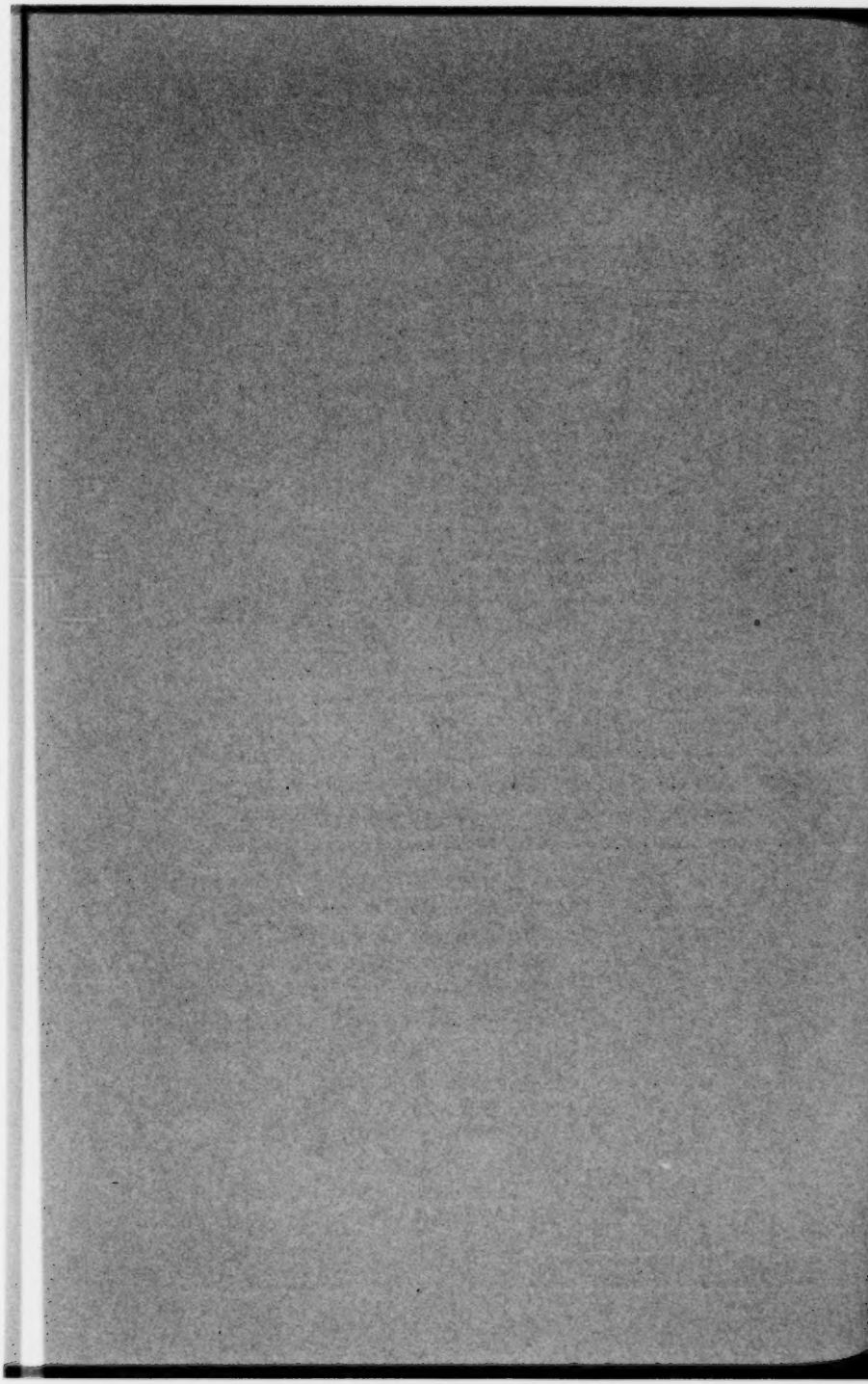
SAMUEL SILBIGER,
Counsel for George E. Eddy.

PERCIVAL E. JACKSON,
Counsel for Prudence Securities Advisory Group.

Dated: New York, May 19, 1942.



INDEX

Subject Index

Cases Cited

Other Authorities Cited

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RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Circuit Court of Appeals (R. 519) is reported in 125 F. (2d) 650.*

The opinion of the District Court (R. 500) is not reported.

The opinion of the Special Master is not reported but is printed in the record (R. 333).

Jurisdiction

The opinion of the Circuit Court of Appeals was rendered February 3, 1942, and the decree and order for the mandate thereon was entered February 24, 1942.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. Code, Title 28, Sec. 347).

Questions Presented

Petitioner, acting as trustee of an express trust under a written trust agreement, held a trust fund to secure bonds of the Debtor. Upon confirmation of the Plans in a proceeding for the reorganization of the Debtor corporation under Section 77B of the Bankruptcy Act, the District Court, in order to make effective, consummate and carry

* The Circuit Court of Appeals on a prior appeal herein, to which petitioner was a party, upheld the jurisdiction of the bankruptcy court over petitioner's account and the accounts of the other Corporate Trustees of the Debtor's bond issues, and over objections based upon the Trustees' acts in wrongfully diverting and disbursing the Trust Funds in violation of the Trust Agreements. This opinion of the Circuit Court of Appeals is not printed in this record, but is reported *sub nom., Central Hanover Bank & Trust Co. et al.* v. *President & Directors of the Manhattan Co. et al.,* 105 F. (2d) 130. The opinion of the District Court in that case is not reported and is not printed in this record.

out the Plans, approved a Modified or Supplemental Trust Agreement, appointed a Successor Trustee, authorized and directed petitioner to transfer and deliver the Trust Fund to its Successor Trustee and to account in the reorganization proceeding for its acts as Trustee. The Supplemental Trust Agreement relieved the Successor Trustee of any responsibility for the acts or omissions of its predecessor and of any obligation to take any action against its predecessor. Objections to petitioner's account were filed by respondents on their own behalf and on behalf of all bondholders, charging that petitioner, while acting as such Trustee, had wrongfully diverted and disbursed cash and securities constituting part of the Trust Fund in violation of the Trust Agreement. The questions are:

1. Whether the Court below correctly applied and interpreted New York law in holding that petitioner's liability is to restore the trust *res*.

2. Whether the Court below correctly held that the objections are not barred by any statute of limitations.

3. Whether the bankruptcy court has jurisdiction over the subject matter of the objections.

Statement

Petitioner, we submit, has omitted material facts which conclusively demonstrate that it is a trustee of an express trust, rather than a mere depositary or custodian as it contends. Petitioner also questions the jurisdiction of the bankruptcy court. In the Courts below it expressly represented that it did not question such jurisdiction (R. 246), and in its statement of points to be relied upon, it specifically excluded from the issues on the appeal, the jurisdictional issue it now here raises (R. 505). We, therefore, cannot accept petitioner's statement of the case.

The agreement under which petitioner acted, is described in the instrument itself as a "Trust Agreement" (R. 24).

It recites that the Debtor "has determined to establish a Trust Fund" to secure the payment of the Bonds "at any time issued and outstanding" (R. 25). It Witnesseth that the Debtor "has granted, bargained, sold, assigned, transferred, and set over" (R. 25-26) the Trust Fund to the Trustee "to have and to hold said Trust Fund upon the trusts hereby created for the equal and pro rata benefit and security of the holders of Prudence-Bonds, Twelfth Series, issued and to be issued hereunder and to secure the payment of the principal and the interest of said bonds and for all the other uses and purposes and upon the terms and conditions herein declared and expressed" (R. 26). It then provides that the Trust Fund is "for the equal and pro rata benefit and protection of the holders of Prudence-Bonds, Twelfth Series at any time issued and outstanding under this agreement, irrespective of the time of issuance of any such Prudence-Bonds or of the date of the assignment to and deposit with the Trustee of the securities and cash constituting the same" (R. 26). It is further provided, that all Bonds "shall be secured by the Trust Fund irrespective of the actual date of their issuance and negotiation" (R. 37), and that the Trustee's certificate of authentication on the Bonds "shall be conclusive evidence that the bond so authenticated has been duly issued hereunder and is entitled to the benefit of the trusts hereby created" (R. 43).

Under an Article entitled "Concerning the Trust Fund", it is provided that the Fund shall consist of bonds and first mortgages, corporate bonds and notes secured by first mortgages or deeds of trust, U. S. Government securities and other securities legal for trust funds, including cash (R. 26-28, 336).

The Trust Agreement also provided that petitioner's compensation "shall not be limited by any provision of law in regard to the compensation of a trustee of an express trust" (R. 62). It also provided that a Successor Trustee was required to be a New York trust company, or a

national bank, "lawfully authorized to accept and execute trusts" (R. 63).

The Trust Agreement further specifically provided that each bond, note, trust deed and all other securities, except cash, should by separate writing be assigned or endorsed over to the Trustee (R. 27-28). The assignments were executed and physically delivered to the Trustee, accompanied by the securities themselves (R. 362-364). Mortgages in the Trust Fund have been foreclosed, titles have been conveyed, mortgages have been extended and titles to real estate have been insured in reliance upon petitioner's sworn statements that it was the owner and holder of bonds and mortgages forming part of the Trust estate (R. 295, 298, 303-305, 308-313, 442-443). Legal title to cash forming part of the Trust Fund was passed to petitioner by the Trust Agreement itself and by actual delivery of the cash (R. 363-364).

Under the Trust Agreement the Debtor's right to deal with the securities in the Trust Fund was at all times subject to the express conditions and limitations contained therein (R. 34-37). The Courts below have held that petitioner had affirmatively agreed to watch over and to protect the Trust Fund "against any unchartered incursion by the Debtor" (R. 345).

In its verified petition for the judicial settlement of its account, petitioner sets forth that it is "duly authorized and empowered to hold in trust the properties held by it in and by the Trust Agreement hereinafter mentioned and to execute the trusts created thereby" and that as "Trustee under the foregoing Trust Agreements, your petitioner has administered the trusts therein set forth" (R. 74).

The Courts below found that petitioner had actual possession of and legal title to the Trust Fund (R. 443, 444, 446); that petitioner is a trustee of an express trust (R. 525, 502, 476) and that it "was never a mere depositary and agent for" the bondholders (R. 445). The Courts below further found that the Trust Agreement has not been satis-

fied or annulled (R. 451) and that the "Trust created" has "never been repudiated" to the knowledge of the bondholders (R. 450).*

The seventeen (17) other Trust Agreements made by the Debtor to secure its other Series of Bonds were, with variations not here material, substantially like the one here involved (R. 364).

The order made on June 29, 1934, approving the Debtor's petition for reorganization restrained suits against the Debtor and its property (R. 365-368). Shortly thereafter, the District Court enjoined a number of suits for accountings brought by bondholders in the State Courts against petitioner and most of the other Corporate Trustees (R. 427-431). One of the injunction orders was appealed and upheld by the Circuit Court of Appeals (*In re Prudence-Bonds Corporation*, 75 F. [2d] 262). In applying for the injunction order which was upheld in the case just cited, Chemical Bank and Trust Company, Trustee of the Fifteenth Series, stated in its petition verified October 9, 1934, that the "accounting asked for by said complaint is similar to the accounting that your petitioner, the Corporate Trustee, will make at the proper time to this Court" (R. 429) and that "such accounting to another court would be highly inappropriate" (R. 430). On another appeal taken at about the same time to the Circuit Court of Appeals from an order made in the reorganization proceedings on February 8, 1935 (*In re Prudence-Bonds Corporation*, 77 F. [2d] 328), counsel for the petitioner and counsel for several other Corporate Trustees, in supporting the Court's right to enjoin the State Court accounting actions, pointed out to the Court that "presumably the Trust Companies will be required to account in the bankruptcy court for their acts as trustees under the respective trust indentures" (R. 430-431).

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* There are outstanding approximately 6900 Twelfth Series bonds, of the aggregate principal amount of $4,358,300, held by approximately 2800 bondholders residing in New York State and elsewhere (R. 369). Prior to the reorganization, most of these bonds were bearer bonds; some still are (R. 369-370).

The Debtor then proposed a separate Plan for each of its eighteen (18) Series of Bonds and a so-called General Plan of Reorganization providing for the *modus operandi* of carrying out the separate Series Plans (R. 370). Both the Debtor and The Prudence Company, Inc., the Guarantor, were subsequently found to be insolvent (R. 365, 370). The Plans were confirmed (R. 371), the General Plan providing for the formation of a new corporation to be wholly owned by the bondholders (R. 377). Each separate Series Plan provided for a Modified or Supplemental Trust Agreement (R. 375-377). The Effective Date was fixed as March 1, 1938 (R. 378).

As part of the proceedings to make effective, consummate and carry out the Plans, the District Court:

(a) Approved the appointment of City Bank Farmers Trust Company* as Trustee of each of the eighteen (18) Series of Bonds under a Supplemental Trust Agreement for each Series;

(b) Approved the form of Supplemental Trust Agreement;

(c) Authorized and directed the Debtor and its 77B Trustees to assign all their right, title and interest in the Trust Fund collateral securing the eighteen (18) Series of Bonds to the New Corporation; and

(d) Authorized and directed the Corporate Trustees under the original Trust Agreements to assign, convey and deliver their respective Trust Funds to City Bank Farmers Trust Company, as Trustee under the Supplemental Trust Agreements, and to file accounts of their respective acts as Trustees and to make application for the judicial settlement thereof (R. 378-388).

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* City Bank Farmers Trust Company was Trustee under five of the original Trust Agreements (R. 383).

Neither petitioner nor any of the other Corporate Trustees objected to or appealed from the order authorizing and directing them to account (R. 160).

The Plan of Reorganization for the Twelfth Series specifically provided that the rights and claims of bondholders other than their rights and claims against The Prudence Company, Inc., upon its guarantee, shall be "preserved" and that the Modified or Supplemental Trust Agreement "shall contain appropriate provisions, consistent with the Plan for their preservation and enforcement" (R. 375). As to bondholders' rights against the Guarantor, the Plan provided that such rights "are reserved unto them" (R. 376).*

Each Supplemental Trust Agreement accordingly provides that the bondholders' rights against the Guarantor "are reserved unto them" and that their "preserved" rights "shall be deemed for all purposes in full force and effect and may be enforced in accordance with the Original Trust Agreement as hereby amended" (R. 395). The Supplemental Trust Agreements vest the New Corporation, which had assumed payment of the bonds (R. 191, 451), with the power "to demand, receive, sue for and recover all moneys and other properties and rights forming part of the Collateral and to give full acquittances therefor" (R. 392). Each Supplemental Trust Agreement (except those in the five Series in which City Bank Farmers Trust Company continued as Trustee), also provides that City Bank Farmers Trust Company, the Successor Trustee, "shall not be responsible in any manner whatsoever for the acts or omissions of its predecessors as trustee under the Original Trust Agreement" and "shall not be required to institute any actions, legal or equitable, against any of its predecessors as trustee under the Original Trust Agreement" (R.

* The bondholders' rights against the Debtor having been reorganized and their rights against the Guarantor having been "reserved unto them" (R. 376), their only remaining or "preserved" rights were to the Trust Funds and against the Corporate Trustees.

390, 218). This last provision had been inserted with the approval of the District Court, at the request of City Bank Farmers Trust Company and as a condition to its acceptance of the Trusts under the Supplemental Trust Agreements (R. 389).

In the fall of 1938, the Corporate Trustees filed their accounts and respectively petitioned the District Court for their discharge from all responsibility with respect to their acts and proceedings as Trustees from the inception of the Trusts, and with respect to all matters contained in their accounts (R. 403). Thereupon, a question was raised as to the jurisdiction of the bankruptcy court (R. 414). The District Court decreed it had no jurisdiction over the accounts or any objections thereto, in so far as they related to acts of the Corporate Trustees prior to the date of the commencement of the reorganization proceeding, in permitting the Debtor to substitute or withdraw Trust Fund securities in alleged violation of the Trust Agreements (R. 209-211, former record *). The Court, however, directed that an appeal be taken so that "this question of jurisdiction may be finally determined and any expense and delay entailed thereby justified" (R. 201, former record). Upon the appeal the order of the District Court was unanimously reversed (*Central Hanover Bank & Trust Co. et al.* v. *President and Directors of the Manhattan Co. et al.*, 105 F. [2d] 130).

Upon the mandate of the Circuit Court of Appeals, the District Court then made an order on July 12, 1939, reversing its former order and decreeing that "to make effective, consummate and carry out" the confirmed Plans, it had and thereby took full, complete and exclusive jurisdic-

* Record on appeal, *Central Hanover Bank & Trust Co. et al.* v. *President & Directors of the Manhattan Co. et al.*, 105 F. (2d) 130, herein referred to as "former record". In the Circuit Court of Appeals this record was incorporated into the present record by reference as it was on file there (R. 203), but it has not been filed with this Court on the present petition.

tion over the accounts and all objections thereto (R. 206-207). Such order provided that any objections of the New Corporation and the 77B Trustees of the Debtor would be deemed and constituted to be made on their own behalf and on behalf of the bondholders, authorized bondholders to join in and adopt objections of the New Corporation and the 77B Trustees of the Debtor and continued the stay of all other accounting suits (R. 207-208).

The objections filed by respondents to petitioner's account are specifically made on behalf of the Objectors therein named and on behalf of all bondholders (R. 106-132).

The accounts and objections were subsequently referred to a Special Master (R. 427).

The objections charge that petitioner, as Trustee, released and disbursed, in violation of express provisions of the Trust Agreement, particularly Section 6 of Article I (R. 34), securities and cash constituting part of the Trust Fund (R. 106-132). The charge made must here be deemed true, no inquiry or trial on the merits having yet been had (R. 526, 447, 333).

While objections in other Series were being tried on the merits (R. 333), petitioner moved for an order dismissing the objections to its account, and for summary judgment approving its account, solely upon the grounds that none of the Objectors had any status to file the objections and that the objections were barred by the New York Statute of Limitations (R. 12).

Petitioner's motion was in all respects denied (R. 10). Petitioner appealed and the Circuit Court of Appeals in the decision now sought to be reviewed unanimously affirmed the order of the District Court (R. 519).

I

The Circuit Court of Appeals has applied and correctly interpreted New York law in holding that in the situation here presented petitioner's liability is to restore the trust *res*.

Before discussing the New York law applicable to trustees in the circumstances here, we shall refer briefly to decisions making it clear beyond argument that the Courts below correctly decided that under the law of New York petitioner is a trustee of an express trust (R. 525, 502).

A

The Trust Agreement created an express trust.

In New York an express trust is a trust created by expression or intentional act of the parties as distinguished from one created by operation of law (*Hammerstein* v. *Equitable Trust Co.*, 156 App. Div. 644; Pomeroy's Equity Jurisprudence [4th Ed.], vol. 1, sec. 152; Perry on Trusts [7th Ed.], vol. 1, sec. 24). The only requirements of an express trust of personal property such as here involved are, "'(1) a designated beneficiary; (2) a designated trustee who must not be the beneficiary; (3) a fund or other property sufficiently designated or identified to enable title thereto to pass to the trustee, and (4) the actual delivery of the fund or other property, or of a legal assignment thereof to the trustee, with the intention of passing legal title thereto to him as trustee'" (*Brown* v. *Spohr*, 180 N. Y. 201, 209). As stated in Perry on Trusts, *supra*, "As express trusts are directly declared by the parties, there can never be a controversy whether they exist or not."

There should not be any controversy as to whether this Trust Agreement created an express trust, because it was

directly declared and expressed by the parties. And it clearly appears (*supra*, pp. 3-6) that the four essential elements of an express trust are here present.

In *Prudence Co., Inc.* v. *Central Hanover Bank & Trust Co.*, 237 App. Div. 595 (affd. 261 N. Y. 420), the Court in construing a similar Trust Agreement of The Prudence Company, Inc., stated (p. 600):

> "The bank is not a depositary. It is a trustee. Its duty is to make certain, so far as possible, that the trust shall attain its end."

In *In re Prudence-Bonds Corporation*, 75 F. (2d) 262, the Circuit Court of Appeals, in passing upon the relationship created by the Trust Agreement securing Prudence-Bonds, Fifteenth Series, stated (p. 263):

> "But the pledgee at bar though in possession is not an ordinary pledgee; it is a trustee, bound by the terms of the deed to act only in the interest of its beneficiaries, the bondholders."

In *In re The Prudence Company, Inc.*, 82 F. (2d) 755, the Circuit Court of Appeals stated (p. 755):

> "Each of the appellants is the trustee under one or more trust agreements executed by Prudence-Bonds Corporation under which certain mortgages on real estate and other securities were assigned to the appellants to hold in trust upon the terms stated for the benefit of the owners of bonds issued by Prudence-Bonds Corporation in accordance with the trust agreement."

It conclusively appears, therefore, that the Trust Agreement here involved created an express trust. As the Circuit Court of Appeals stated (R. 525):

> "Finally, there can be no doubt that the instrument creating this 'series' set up an 'express trust'; it is

> exceptionally explicit, and is replete with language that admits of no other interpretation. A precisely similar deed was held to create a trust in *Manhattan Co.* v. *Prudence Co.*, 266 N. Y. 202."

Despite these conclusive decisions that the petitioner is a trustee of an express trust, it still maintains that it is a mere depositary or custodian, and that legal title to the Trust Fund securities was in the Debtor. This is an astonishing position for the petitioner to take, in view of the fact that it, in conjunction with Corporate Trustees of other Series of Bonds of the Debtor, filed a brief as *amici curiae* in the case cited by the Circuit Court of Appeals (*Manhattan Co.* v. *Prudence Co., supra*), urging that legal title to the Trust Fund collateral was in the plaintiff as Trustee (see also R. 175-178). The Court of Appeals there held that a trust was created and that legal title to the Trust Fund was in the plaintiff as Trustee.*

One moment the petitioner is urging that the New York law applies to the issues in this case, and the next moment we are asked to forget that the highest State Court ruled, at the request of petitioner, that it was a trustee owning and holding the legal title in trust for the bondholders.

There can be but one explanation for this unusual conduct on the part of the petitioner. In the hope of bringing itself within the rulings of the State Courts in cases involving mortgage certificate issues of New York title companies, it now wishes to have it held that it is a mere depositary or custodian, that there is no trust, and that it did not have legal title. These certificate issue cases, which are discussed *infra* in Point II, have been distinguished by the Circuit Court of Appeals from the instant case.

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* The plaintiff in that case was Trustee of Prudence-Bonds, Fifth and Ninth Series.

B

In New York the law is settled that upon an accounting, the liability of a trustee who has wrongfully depleted or disbursed a trust fund is to restore and replenish the fund. The right to enforce this liability is a derivative one and, in the case of a corporate bond issue, such liability can be enforced on behalf of all bondholders, irrespective of when they acquired their bonds.

Petitioner's first contention is that a trustee holding a trust fund to secure the payment of corporate trust bonds is not, under the law of New York, liable on an accounting to restore to the fund cash and the value of any other trust property wrongfully diverted or disbursed from the Fund by the trustee in violation of the express provisions of the trust instrument.* It is petitioner's position that in such

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* After contending throughout that an individual action at law for damages is the only remedy available to bondholders and that such remedy is barred by the Statute of Limitations, petitioner ends its brief with the statement that (Petitioner's Br., p. 33):

> "The present controversy properly belongs, we submit, in the State court having jurisdiction over the indenture trustee, *to which such trustee is required to account* and the law of which must in any event determine the result." (Italics ours.)

When such statement is viewed in the light of petitioner's prior conduct in this proceeding, the disingenuous nature of its attempt to deprive bondholders of the security for their bonds is apparent. In this very case, both petitioner and attorneys representing petitioner applied for and were awarded allowances for services and expenses (see *In re Prudence-Bonds Corporation,* 122 F. [2d] 258, 265), including services and expenses in 1935 in opposing accounting suits brought by bondholders in the State Courts (R. 431-433). These suits, as we have seen, were subsequently enjoined by the bankruptcy court (R. 427-430) and some were later discontinued (R. 433). They had been "vigorously" opposed by petitioner and its attorneys upon the ground, among others, as petitioner's own attorneys stated in their petition herein for an allowance, "that the proper forum for an accounting was in the reorganization proceedings of Prudence-Bonds Corporation" (R. 431). Now petitioner says that the State Court is the proper forum for any accounting suit, but that the six-year Statute of Limitations (New York Civil Practice Act, Sec. 48), which petitioner says has been running meanwhile, would apply to any objections.

a case the trustee is liable only to those persons who owned a bond or bonds on the date or dates of the trustee's wrongs; that neither those bondholders nor a successor trustee has any right to maintain a class or representative suit against the recreant trustee for the benefit of the trust fund; that the only remedy available to any such bondholder is to sue the trustee in an individual action at law for such an amount of damages as the individual bondholder could establish he personally suffered; and that any sum recovered in such an action would not go back into the depleted trust fund, but would belong solely to the bondholder bringing the action.

A moment's reflection upon the position taken by petitioner should show that, if upheld, it would, as the Circuit Court of Appeals stated, work "the most perfect injustice" (R. 523). If any such principle were adopted the long established power and jurisdiction of courts of equity to protect, preserve and enforce trusts would cease to exist. Any such rule would place in the hands of a trustee a power to destroy and terminate a trust and frustrate the purposes for which it was created. He could part with the trust fund, or a part thereof, and the bondholders or beneficiaries would be powerless to compel him to return to the fund the equivalent of the wrongfully diverted trust property so that it might continue to be held upon the trusts specified.

The Circuit Court of Appeals, after a careful analysis of the cases relied upon by petitioner, stated that the New York decisions "countenance no such unhappy result" (R. 524).

On the former appeal, the Court below held that the liability of the Corporate Trustees of the Debtor's bond issues for any diversion or waste of the Trust Funds would be to "restore the waste of assets" or to "restore the *res*" and that the recoveries on the objections "will in any event be part of the security" (*Central Hanover Bank & Trust Com-*

pany, Trustee, et al. v. *President and Directors of the Manhattan Company, Trustee, et al., supra*).

In the decision now sought to be reviewed, the Court below has again held it to be immaterial that the Trustee did not personally profit by the wrongful diversions of the trust *res,* or that some bondholders who owned their bonds at the time of the acts objected to have since transferred them to others. It has also held that petitioner's liability is to restore the Trust Fund and that such liability can be enforced on behalf of all bondholders.

These decisions are in accordance with basic principles of the law of trusts long established in New York and elsewhere. As long ago as *May* v. *Le Claire,* 11 Wall. 217, this Court, in ordering an accounting, held that if restoration of the specific trust property is impossible, the court may compel the trustee to "account for its present value" (11 Wall. 217, 237). That principle was applied in *Isenberg* v. *Trent Trust Co.,* 31 F. (2d) 553 (on rehearing of same case, 26 F. [2d] 609); cert. den. 279 U. S. 869. There the trustee had wrongfully failed to reduce to possession certain stock forming part of the trust estate. On an accounting by the trustee, it was held that the beneficiaries were entitled to restoration of the lost trust property in kind or to its value, the Court stating that this rule is "abundantly supported by authority" (31 F. [2d] 553, 555).

This principle was also applied to a trust securing a corporate bond issue in *Cherry* v. *Howell,* 66 F. (2d) 713, a representative suit in equity brought by two Class D bondholders of the Southern Guaranty Loan Company on behalf of themselves and all other Class D bondholders against directors of that company. It was alleged that the loan company diverted various funds held by it as trustee for the bondholders and that the directors sued were liable because they committed and caused the trustee to commit the alleged wrongful diversions of the trust property. The Court held that the trustee was a necessary party because "the liability which resulted was to replenish the fund so that it might continue to be held upon the trust specified"

and because "any recovery will be for the benefit of the trust estate as such and not for the benefit of the plaintiff personally" (66 F. [2d] 713, 716). In that case the Circuit Court of Appeals relied upon, among other cases, the case of *Western R. R. Co.* v. *Nolan,* 48 N. Y. 513.

The law as enunciated in the foregoing cases has long been the settled law of the State of New York (*O'Beirne* v. *Bullis,* 80 Hun 570, affd. *sub nom, O'Beirne* v. *Allegheny & Kinzua R. R. Co.,* 151 N. Y. 372; same case on second trial as to certain defendants, *O'Beirne* v. *Bullis,* 2 App. Div. 545, affd. 158 N. Y. 466, rearg. den. 158 N. Y. 719; *Harvey* v. *McDonnell,* 113 N. Y. 526; *Harrison* v. *Union Trust Co.,* 80 Hun 463, affd. 144 N. Y. 326; *Weetjen* v. *St. Paul & Pacific R. R. Co.,* 4 Hun 529; *Weetjen* v. *Vibbard,* 5 Hun 265; *Atlantic Trust Co.* v. *Crystal Water Co.,* 72 App. Div. 539; *Robinson* v. *Adams,* 81 App. Div. 20, affd. 179 N. Y. 558; *Smith* v. *Stevenson Brewing Co.,* 117 App. Div. 690; *Agne* v. *Schwab,* 123 App. Div. 746; *Hart* v. *Goadby,* 138 App. Div. 160; *Herrington* v. *Laimbeer,* 252 App. Div. 66). It has also been consistently applied in the Federal Courts (*Backer* v. *Levy,* 82 F. [2d] 270; *In re Dolcater,* 106 F. [2d] 30).

The right of a *cestui* to compel the replenishment of a trust fund is essentially a derivative one, because it is the trustee who is vested with legal title to the fund. Of course, where as here, a trustee comes into court and accounts, he is before the court in his representative capacity. And any beneficiary of an express trust may call the trustee to account (*Hart* v. *Equitable Life Assurance Society,* 172 App. Div. 659). Indeed, the *cestui's* right to an accounting does not in any way affect his right also to sue a fraudulent grantee or vendee (*Agne* v. *Schwab, supra; Noll* v. *Smith,* 250 App. Div. 453).

Suits for the benefit of a class are provided for by the New York Civil Practice Act (Sec. 195) and the Federal Rules of Civil Procedure (Rule 23). And in New York the rules respecting parties authorized to maintain repre-

sentative or class suits in equity are still the same as those established by the chancery courts (*McKenzie* v. *L'Amoureaux,* 11 Barb. 516, cited with approval, *Brenner* v. *Title Guarantee & Trust Co.,* 276 N. Y. 230; see also *Atkins* v. *Trowbridge,* 162 App. Div. 629; *New York State Railways* v. *Security Trust Co.,* 135 Misc. 456).

The *O'Beirne* cases, *supra,* are direct authority for the proposition that in New York a holder of corporate bonds secured by a trust indenture has a derivative right to maintain a representative suit on his own behalf and on behalf of all other bondholders to compel the turning over to a mortgage trustee of the value of property which it had been agreed should be covered by the lien of the mortgage as security for bonds issued thereunder. Certain defendants there had agreed that various timber lands would be subjected to the lien of the trust mortgage. Plaintiff had demanded that the trustee bring suit to enforce the agreement and, on its refusal, commenced the suit on his own behalf and on behalf of all bondholders. Plaintiff's right to maintain the suit was strenuously contested. The New York Court of Appeals sustained his right to sue in such representative capacity to compel the specific performance of the agreement or "to compel the defendant to pay to the trustee, for the security of the bondholders, the value of said lands" (151 N. Y. 372, 377). It appearing that the defendants in question were not the owners of the land which they had agreed should be subjected to the lien of the mortgage, the decree provided for the payment of money to the trustee.*

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* The decree provided:

"That the defendants Spencer S. Bullis and Mills W. Barse at once pay to the Central Trust Company of New York the sum of $292,125.00 with interest thereon at the rate of five per cent per annum from the first day of February, 1892, for the *pro rata* benefit of the plaintiff, James R. O'Beirne, and all other holders, of the first mortgage bonds of the defendant, The Allegheny and Kinzua Railroad Company" (*Matter of Bullis,* 68 App. Div. 508, 515-516).

Eight years had elapsed between the bringing of the suit and the affirmance of the final judgment against Bullis and Barse by the Court of Appeals. Still, the decree directed that the money substitute for the property be paid over to the trustee for the *pro rata* benefit of all bondholders. Thus the judgment inured to the benefit of all bondholders irrespective of when they acquired their bonds.

In *Zebley* v. *Farmers L. & T. Co.*, 139 N. Y. 461, the Court of Appeals held that the plaintiff, who was the owner of eleven bonds, was entitled to an accounting against a trustee who had improperly transferred property held by it as security for the bonds, even though it appeared from the complaint and arguments of counsel in the case that he had acquired his bonds subsequent to the alleged wrongful transfer of the trust property.*

The rule of these cases has never been modified or overruled in New York, as we shall see in our subsequent discussion of the cases relied upon by petitioner. The *O'Beirne* cases, *supra*, go much further than is necessary to support the order below. The property there involved never had actually been in the trust fund; here, the petitioning Trustee is charged with wrongfully handing over securities and cash constituting a part of the Trust Fund in violation of express provisions of the Trust Agreement.

The New York courts traditionally have given to corporate trust bonds "every practicable facility as the basis of commercial transactions" (*Reynolds* v. *Title Guarantee & Trust Co.*, 240 N. Y. 257, 262). It is also well established law both in New York and in the Federal Courts that, in equity, the security follows the debt (*Vail* v. *Foster*, 4 N. Y. 312; *Chapman* v. *Brooks*, 31 N. Y. 75; *Craig* v. *Parkis*, 40 N. Y. 181; *Central Trust Co. of N. Y.* v. *N. Y. Equipment Co.*, 87 Hun 421; *Edwards* v. *Bay State Gas Co.*, 184

* The complaint had alleged: "That this plaintiff and the holders of said eleven bonds had no notice of * * * said transfer * * *" (Record on Appeal, p. 9, *Zebley* v. *Farmers L. & T. Co.*, *supra*).

Fed. 979; *Virginia Ry. & Power Co.* v. *Davis,* 284 Fed. 479, cert. den. 260 U. S. 746; *Colebrooke on Collateral Securities,* Sec. 79; C. J. S. Bonds, Sec. 74). In *Virginia Ry. & Power Co.* v. *Davis, supra,* the Court stated (284 Fed. 479, 481):

> "It makes no difference whether Davis acquired the bonds before or after the diversion. The assignment of the bonds, whenever made, carried with it all the security provided by the mortgage and all the rights, interests, and remedies of the mortgagee. Davis, as assignee, had the right to follow the mortgaged property wherever found, except in the hands of a purchaser for value without notice. 3 Pomeroy's Eq., Sec. 1210; *Chicago, M. & St. P. Ry. Co.* v. *Third Nat. Bank,* 134 U. S. 276, 10 Sup. Ct. 550, 33 L. Ed. 900; *Shields* v. *Ohio,* 95 U. S. 319, 24 L. Ed. 357; *Fosdick* v. *Schall,* 99 U. S. 235, 25 L. Ed. 339; *Linder* v. *Hartwell R. Co.,* (C. C.), 73 Fed. 320; *Zinn* v. *Denver Livestock Com. Co.,* 68 Colo. 274, 187 Pac. 1033."

Not only is it an established principle of equity that the security follows the debt; in this case the principle is written into the Trust Agreement in clear unmistakable language. It provides that it was made in consideration of "the purchase and acceptance from time to time of said Prudence-Bonds by the holders thereof" (R. 25). It also provides that the Trust Fund is for the equal and *pro rata* benefit and advantage of all bonds, irrespective of when the securities and cash "constituting" the Fund (R. 26), were deposited with the Trustee and irrespective of the actual date of the issuance and negotiation of the bonds (R. 25, 26, 37, 43, see *supra,* p. 4).

If the right to compel a trustee to restore a wrongfully depleted trust fund to its proper level as constituted by a trust agreement did not follow the security and run with the bond, no one could rely upon a trust agreement or a trustee and no one would be safe in selling or purchasing a collateral trust bond until he first went to the trustee and made an investigation of all acts of the trustee with respect to the trust fund from the inception of the trust. If peti-

tioner's contentions were correct, and a person purchased a Prudence bond today, and yesterday the Trustee dissipated the entire Trust Fund, the new bondholder would have no security whatever for his bond and no right to complain of the Trustee's wrong. As the Circuit Court of Appeals stated (R. 524):

> "* * * For the truth is—whatever may be said as to other breaches—that whatever remedy the law gives for an actual depletion of the *res* as against a mere injury to it—is a substitute for the very subject matter of the transfer itself; and that, unless it passes to the assignee, the transfer has been frustrated, as would very plainly appear if the trustee had parted with the whole *res*. That we should not so construe the intent of the parties as to foil their venture, is a cardinal principle of all interpretation."

The authorities discussed above dispose of petitioner's argument that in New York a trustee who has wrongfully parted with trust property cannot be compelled to restore the trust fund. They also dispose of its argument that a holder of a corporate trust bond has no interest in any such recovery if he did not own his bond at the time of the trustee's wrongful depletion of the trust fund.

It is obvious that the decision below is in accordance with the law of New York governing the liability of a trustee of an express trust, whether it be a trust securing an issue of corporate bonds or for some other purpose. Indeed, in *Elkind* v. *The Chase Bank*, 259 App. Div. 661, 665, aff'd no op. 284 N. Y. 726, one of the cases principally relied upon by petitioner (R. 522), the Court clearly recognized the distinction between the suit then before it and a representative suit by a bondholder to compel restoration of a trust *res* by stating that the suit in the *Elkind* case was unlike "a suit to recover property that was subject to the lien of the mortgage".

The cases principally relied upon by petitioner are *Mittlemann* v. *President etc. of Manhattan Co.*, 248 App. Div. 79, aff'd no op. 272 N. Y. 632; *Weil* v. *President etc. of*

Manhattan Co., 275 N. Y. 238; *Rabinowitz* v. *President etc. of Manhattan Co.*, 275 N. Y. 453; *Hendry* v. *Title Guarantee & Trust Co.*, 255 App. Div. 497; *Elkind* v. *The Chase Bank, supra,* and *Emmerich* v. *Central Hanover Bank & Trust Co.* (not officially reported), Sup. Ct., N. Y. Co., N. Y. Law Journal, March 10, 1942, p. 1040. Each of these cases was carefully considered and distinguished by the Circuit Court of Appeals, with the exception of the *Emmerich* case, which had not yet been decided (R. 520-525).

The *Weil, Rabinowitz* and *Mittlemann* cases involved certificate issues of New York Title & Mortgage Company. They were actions at law by "Schackno Act" * Trustees, having limited statutory powers. The object of the action in each case was to recover damages for alleged torts of the defendant, with whom the Title Company had deposited various bonds and mortgages, against which mortgage certificates representing undivided shares therein has been assigned to certificate holders. The defendant bank was a mere depositary and agent for the certificate holders. It was not a trustee and did not have and never had legal title to the deposited bonds and mortgages (*Matter of People* [Title & Mtg. G. Co. of Buffalo], 264 N. Y. 69, affirming 149 Misc. 643; *Matter of People* [New York Title & Mtg. Co.], 264 N. Y. 475; *Title G & T. Co.* v. *Mortgage Comm.*, 273 N. Y. 415; *Matter of New York Title & Mtg. Co.*, 241 App. Div. 351; *Matter of Lawyers Westchester Mtg. & T. Co.*, 247 App. Div. 895; *Abrams et al.* v. *Title G. & T. Co.* (not officially reported), Sup. Ct., N. Y. Co., N. Y. Law Journal, May 9, 1942, p. 1978; *Wiltsie on Mortgage Foreclosures* (1939), Vol. 1, p. 492).

The petitioner erroneously asserts that in the mortgage certificate cases relied upon by it, the question whether the defendant was a trustee or not had no part in the *ratio decidendi* of the cases and was not regarded as of any significance. In the *Weil* case, the attorneys for the defend-

* N. Y. Unconsolidated Laws, Secs. 1796 *et seq.*, L. 1933, c. 745, as amended.

ant placed considerable reliance upon the fact that in these, and in other cases involving mortgage certificates, title to the deposited bonds and mortgages had not been assigned or transferred to the defendant. A considerable portion of their brief was devoted to showing that the defendant was a mere depositary and not a trustee, that its rights and liabilities as depositary were not to be governed by the rules applicable to trustees of express trusts, and that since the defendant bank was not a trustee but merely a depositary, custodian or bailee, no action for an accounting would lie against it (*Weil* case, *supra,* Record on Appeal, pp. 74-78, defendant-respondent's brief). The Court of Appeals agreed and so held, stating (275 N. Y. 238, 243):

> "In the action at bar the defendant was not the owner of the mortgages deposited with it. Neither was it a trustee of the mortgages deposited." *

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* It is only after reorganization in proceedings under the "Schackno Act", *supra,* or the "Mortgage Commission Act" (New York Unconsolidated Laws, Sec. 1751 *et seq.,* L. 1935, c. 19, as amended), that the bonds and mortgages in which certificate holders had undivided interests are held by trustees. Upon reorganization, each certificate issue is operated under a separate standard form declaration of trust. The certificates are held by over 200,000 investors, the corpus of these trusts exceeds $700,000,000 and their administration in and about the City of New York is lodged in the hands of over 250 trustees appointed by Justices of the New York Supreme Court. These trustees must account to the court annually and upon objections to their accounts they have, on occasion, been surcharged and ordered to reimburse the estate with the amount of the surcharge. The mortgage certificates are dealt in on the open market and change hands daily and it is quite obvious that many persons who are certificate holders at the time of the trustee's annual accounting were not certificate holders at the time of a wrongful disbursement or other act of a trustee which subjects him to a surcharge. And it is also manifest that a person acquiring a certificate the day before a surcharge is paid into the estate obtains the benefit thereof. No one has yet suggested in the New York courts that these trustees are liable only to certificate holders who owned their certificates on the day a trustee made an improper disbursement or otherwise depleted the trust estate. Quite the contrary, these trustees are treated like any other trustee of an express trust (see Article entitled "The Administration of Guaranteed Mortgage Trusts," and cases cited therein, N. Y. Law Journal, January 6, 1942, p. 58, January 7, 1942, p. 76, and January 8, 1942, p. 96).

Petitioner's contention that the Circuit Court of Appeals misinterpreted the *Weil* and *Mittlemann* cases is further refuted by the recent decision of the New York Court of Appeals explaining its decisions in those cases, pointing out, among other things, that those actions "were brought to enforce tort liabilities" (*Matter of People* [*Lawyers West. Mtg. & Title Co.*], 288 N. Y. 40, 47).

The *Hendry* case, *supra,* related to a mortgage certificate issue of Title Guarantee and Trust Company. The certificates there involved also created a legal relationship distinctly different from the legal relationship created by the bonds, Trust Agreement and Trust Fund here involved. A mortgage certificate of Title Guarantee and Trust Company is not a secured promise to pay; it is an assignment of an undivided share in a mortgage. Holders of such certificates are merely "tenants in common, each entitled to an aliquot share of the mortgage referred to in the certificate" (*Title G. & T. Co.* v. *Mortgage Comm.,* 273 N. Y. 415, 422). The relationship between the Title Company and the certificate holders was not that of trustee and cestui que trust (see cases cited *supra,* p. 22). Legal title to the underlying mortgage, although originally acquired and held by the Title Company, was, by the issuance of mortgage certificates, assigned in aliquot shares to the certificate holders, who then became tenants in common of the legal title to the mortgage. The Title Company, as provided in the mortgage certificates, merely held the mortgage documents as "agent and depositary" for the certificate holders (cf. *Fisher* v. *Title G. & T. Co.,* 176 Misc. 166, affd. 262 App. Div. 293, affd. 287 N. Y. 275). There was no trust fund and the legal relationship between the Title Company and the certificate holders was only such as exists between an assignor and assignee or principal and agent.

Furthermore, mortgage participation certificates of Title Guarantee and Trust Company, unlike Prudence-Bonds, did not pass from hand to hand by delivery or assign-

ment (R. 357, 370). The mortgage certificates in the *Hendry* case, in the usual form of Title Guarantee and Trust Company certificates, specifically provided (see *Title G. & T. Co.* v. *Mortgage Comm.*, 273 N. Y. 415, 420):

> "This certificate is not negotiable. The only way that the interest of the purchaser can be transferred is by the surrender of this certificate to the Company duly assigned and the issuing of another certificate to the transferee." *

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* In the *Hendry* case, the attorneys for the defendant Title Company argued with respect to the two certificate holders who had acquired their certificates after the time of the defendant's wrong (Record on Appeal, 255 App. Div. 497; Defendant-Appellant's Brief, pp. 13-14):

> "It is obvious that when their certificates were purchased the purchasers took a participation in the mortgage as it existed at that time. Their rights were in no sense derivative. At that time a portion of the original mortgaged premises had already been released and the mortgage had been extended to cover the remaining premises. These two plaintiffs, or their predecessors then, purchased their certificates in a mortgage on specifically identified property and defendant committed no act to injure their security after their purchase.
>
> "To hold to the contrary would mean that when defendant sold the two certificates referred to, it assigned at the same time a cause of action against itself to recover 7/10ths of the purchase price. Such a result, of course, is absurd. It is clear that defendant acquired the participation in the mortgage which it sold to these two plaintiffs from the former certificate holders who had turned in their certificates upon the extension of the mortgage on January 8, 1930 (see fol. 170). While the former certificate holders may have held a cause of action against defendant for the acts stated in the complaint, any such cause of action was immediately extinguished, in accordance with the theory of merger, when defendant reacquired their participations in the mortgage."

The decision of the Appellate Division in the *Hendry* case was affirmed without opinion by the Court of Appeals, but the unsuccessful certificate holders had not appealed to that Court (280 N. Y. 740).

Thus, when a certificate was transferred back to the Title Company and then to a new certificate holder, a new relationship of assignor and assignee and of principal and agent was created; the Title Company being the assignor or agent and the certificate holder the assignee or principal. Each certificate holder, having acquired his certificate by assignment direct from the Title Company, would have no cause of action against his agent for a wrong which his agent committed to some other principal.

In *Matter of 22-52 44th Street, Long Island City,* 176 Misc. 249, the Court held that upon an assignment of a mortgage participation certificate of the Greater New York Suffolk Title & Guarantee Company, all rights which an assignor had in the security and collateral passed to an assignee in the absence of an express reservation by the assignor, and stated that "this conclusion seems to find ample support in cases relating generally to the assignment of a contractual right" (p. 254). The Court in that case pointed out that the decision in the *Hendry* case was reached upon the authority of other cases which were "decided on the theory that under the facts and circumstances involved *it was not intended by the parties to transfer the rights of action for the previous breach*" (p. 253). (Italics the Court's.)

With these principles and legal distinctions in mind, it becomes clear that the holding in the *Hendry* case to the effect that a certificate holder had no cause of action against the Title Company for a breach of a fiduciary obligation, unless he held his certificate at the time of the act complained of, is not here applicable. As stated by this Court in *McCandless* v. *Furland,* 296 U. S. 140, 163: "Confusion of thought is inevitable unless the position of the wrongdoers as trustees is steadily kept in mind."

The *Elkind* case, *supra,* clearly indicates the difference in New York between the rules applicable to suits for breaches of fiduciary obligation giving rise to a personal tort cause of action at law for damages and a claim on

behalf of beneficiaries of a trust to recover on behalf of the trust fund for the wrongful act of a trustee resulting in a depletion of the trust fund.

The plaintiffs in the *Elkind* case, unlike respondents here, were seeking to compel the defendant trustee to account for money and property which had never been, and never was intended to be, part of the trust fund securing plaintiffs' bonds. The Circuit Court of Appeals clearly distinguished the *Elkind* case and it is unnecesary to add to what they have said (R. 522-524).

The opinion of the Court in the *Emmerich* case, *supra,* is set forth in an appendix to petitioner's brief. The case came up on a motion to dismiss the complaint. The opinion does not state the nature of the action and does not set forth any facts alleged in the complaint. However, an examination of the complaint in the office of the Clerk of New York County discloses that the case was an action for damages brought by the plaintiff individually and not on behalf of all bondholders against the defendant individually and not as trustee. Plaintiff was seeking a personal judgment in his favor. He did not seek the restoration of the trust *res.* The decision is of doubtful validity and, although the facts are somewhat obscure, it would appear to be in conflict with the decision of the New York Court of Appeals in *Zebley* v. *Farmers L. & T. Co., supra,* which was neither cited by the attorneys for any of the parties nor mentioned in the opinion of the Special Term Justice.

None of the cases relied upon by petitioner in any way detract from the force of the decisions of the New York Court of Appeals in the *O'Beirne* and other cases to which we have referred and there is not the slightest conflict between the decision of the Circuit Court of Appeals and the law of New York governing the liability of a trustee of an express trust in the circumstances here.

II

The Circuit Court of Appeals has correctly held that the objections are not barred by any statute of limitations.

In New York the rule is well settled that time does not run against an express trust until open repudiation or adverse possession by the trustee and knowledge thereof on the part of the *cestuis* or until the Trustee invokes the aid of the Court to pass upon his accounts. The Circuit Court of Appeals followed this well-established doctrine (R. 525). The petitioner, however, complains that it cited only one case as an authority, viz., the case of *Ludington* v. *Thompson,* 153 N. Y. 499. But this rule has long been established law and it is based upon the principle that a trustee does not hold a trust fund adversely to the *cestuis* but in possession for their benefit. This rule was restated and followed as long ago as *Oliver* v. *Piatt,* 3 How. 333, 411, a landmark in the law of trusts. It has consistently been followed ever since. In *Anderson* v. *Fry,* 116 App. Div. 740, 742, the Court stated, "no citation of authority is required upon the proposition that mere lapse of time does not bar an action for accounting against a trustee of such a trust."

Numerous other cases could be cited, only a few of which are *Davis* v. *Davis,* 86 Hun 400; *Matter of Sack,* 70 App. Div. 401; *Lammer* v. *Stoddard,* 103 N. Y. 672; *Zebley* v. *Farmers L. & T. Co., supra; Spallholz* v. *Sheldon,* 216 N. Y. 205; *Gisborn* v. *Charter Oak Ins. Co.,* 142 U. S. 326; *Brown-Crummer Inv. Co.* v. *City of Miami,* 40 F. (2d) 508; *Merritt Oil Corp.* v. *Young,* 43 F. (2d) 27; *Norfolk and W. R. Co.* v. *Bd. of Ed.,* 14 F. Supp. 472; *Seelig* v. *First Nat. Bank of Chicago,* 20 F. Supp. 60; Perry on Trusts (7th Ed.), Vol. 2, Sec. 863.

There is also no merit to petitioner's suggestion that the doctrine that time does not run against an express trust

does not apply to trustees acting under trust agreements or trust indentures securing corporate bond issues. *Zebley* v. *Farmers L. & T. Co., supra,* related to the wrongful acts of a trustee under a trust mortgage securing a railroad bond issue. In that case the Appellate Division had sustained a demurrer to the plaintiff's complaint (*Zebley* v. *Farmers L. & T. Co.,* 63 Hun 541). Judge O'Brien, dissenting from the majority opinion of the General Term, stated (pp. 549-550):

> "We have always regarded it as elementary that a *cestui que trust* had a right to demand of a trustee an accounting as to the administration of his trust; and in this respect there can be no distinction between the trustee of a railroad company and any other trustees, for the reason that the former are governed by the general rules that govern trustees in the ordinary performance of the duties of a trust."

The Court of Appeals, in reversing the majority of the General Term and sustaining the view of the dissenting Judge, stated (139 N. Y. 460, 469):

> "Generally the obligation of a trustee to account is not affected by the Statute of Limitations until a denial or repudiation of the trust (Perry on Trusts, vol. 2, sec. 863; Angell on Limitations, secs. 166, 468, 472; *Decouche* v. *Savetier,* 3 Johns Ch. 190, 216; *Flint* v. *Bell,* 27 Hun 158; *Shannon* v. *Howell,* 36 id. 47)."

As stated in Perry on Trusts (7th Ed.), vol. 2, sec. 760:

> "Trustees for bondholders are governed by the general rules that govern trustees in the ordinary performance of the duties of a trust."

Petitioner relies upon the case of *Rhinelander* v. *Farmers Loan & Trust Co.,* 172 N. Y. 519, as an authority for excepting the trust here involved from the doctrine that time does not run against an express trust. The plaintiff in that case did not urge this doctrine and it is not mentioned

in the opinion of the Court of Appeals. Moreover, in that case, the defendant trustee never released or gave up any part of the lien of the trust mortgage which had been made to it by the railroad company, it never had possession of any part of the proceeds of the bonds, the proceeds of the mortgage, and it never acquired title to the mortgaged property, as did the defendant trustee in *Zebley* v. *Farmers L. & T. Co., supra.* In the *Rhinelander* case, therefore, no case could have been made for an accounting (cf. *Harrison* v. *Union Trust Co., supra*).

III

The bankruptcy court in a corporate reorganization proceeding has undoubted jurisdiction over the objections to petitioner's account.

Petitioner's present contention that the bankruptcy court has no jurisdiction to pass upon the objections to its account was not raised in the Circuit Court of Appeals on the appeal which resulted in the order now sought to be reviewed. When its motion was made before the District Court, petitioner filed an affidavit in which it stated, "we have never and do not now question such jurisdiction" (R. 246). In the Circuit Court of Appeals on the appeal from the denial of its motion, petitioner expressly excluded the question of jurisdiction from the issues on appeal (R. 505), and in its brief on appeal again represented to the Court that, "We never have and do not now question the correctness of the decision of this court in upholding the jurisdiction of the district court with respect to this accounting proceeding" (R. 244-245). The decision to which petitioner referred was the decision of the Circuit Court of Appeals on the former appeal in this reorganization proceeding upholding the jurisdiction of the bankruptcy court over the accounts of the Corporate Trustees and objections

thereto (*Central Hanover Bank & Trust Co. et al.* v. *President and Directors of the Manhattan Co. et al., supra*).* Petitioner was an appellee on such appeal (R. 447), but neither petitioner nor any of the other Corporate Trustees (two of them were appellants) petitioned this Court for certiorari.

In the circumstances here, we submit that the jurisdiction question presents no ground for a review of this interlocutory order, especially as the record on which the Circuit Court of Appeals upheld the jurisdiction of the bankruptcy court, although incorporated into the present record by reference (R. 203), has not been presented as a part of the record here.

It is clear, however, that the bankruptcy court has jurisdiction to pass upon the objections filed on behalf of the bondholders. Petitioner's position here that the bankruptcy court is without jurisdiction stems from its erroneous assumption that the recoveries on the objections will not go back into the trust fund or *res* in *custodia legis*, but will belong solely to certain individual bondholders. Petitioner's further contention that in any event the right, arising out of the acts objected to, to compel restoration of the trust *res* would not constitute property of the Debtor within the meaning of the Bankruptcy Act, is unsound as the Circuit Court of Appeals has twice demonstrated in this very case; first by its decision on the former appeal, and again by its decision which petitioner now seeks to review (see also *In re 1775 Broadway Corp.*,

* When the issue of jurisdiction was raised in November, 1938 (R. 414), petitioner, as it later stated in an affidavit, "vigorously supported the proposition that this Court had complete jurisdiction" (R. 244). It filed a supporting affidavit (R. 244) and its attorneys argued in support of jurisdiction (R. 419). While the District Court Judge was deliberating on the issue, petitioner, upon an affidavit of its counsel, obtained an ex parte order permitting it to withdraw its supporting affidavit (R. 244-245). Petitioner in another affidavit later explained this action on its part as taken to co-operate with other Corporate Trustees "who appeared to have more at stake," but that petitioner "did not question the jurisdiction of this Court at any time to compel a complete accounting by the corporate trustees" (R. 244).

79 F. [2d] 108; *In re Nine North Church Street,* 82 F. [2d] 186). On the former appeal the Circuit Court of Appeals analyzed and rejected petitioner's present suggestion that because the Debtor was a participant in the wrongful acts objected to, the recoveries would not constitute property of the Debtor within the meaning of the Act (105 F. [2d] 130). That decision is not in conflict with any decisions of other Circuit Courts of Appeals and is supported by the decision of this Court in *McCandless* v. *Furland, supra.* It is also fully supported by specific provisions of the Bankruptcy Act and decisions under the Act.

In 1935 the Circuit Court of Appeals, following the decision of this Court in *Continental Bank* v. *Rock Island Ry.,* 294 U. S. 648, upheld the jurisdiction of the bankruptcy court over the Trust Fund collateral securing the Debtor's eighteen Series of Bonds (*In re Prudence-Bonds Corporation,* 77 F. [2d] 328, cert. den. 296 U. S. 584; see also *In re Prudence-Bonds Corporation,* 75 F. [2d] 262; *In re Prudence-Bonds Corporation,* 79 F. [2d] 205, cert. den. 296 U. S. 652). Subsequently, the reorganization court determined that the Debtor was insolvent (R. 370). The plans were then confirmed and the "general claimants and the stockholders of the Debtor were excluded from participation" (R. 334), in accordance with established precedents in similar situations (*In re 620 Church St. Corp.,* 299 U. S. 24; *In re Witherbee Court Corporation,* 88 F. [2d] 251, cert. den. 301 U. S. 701).

The rehabilitation of secured debts was a primary purpose of Section 77B of the Bankruptcy Act. The jurisdiction of the bankruptcy court to confirm a plan of reorganization extends to collateral securing the claims of secured creditors, though the Debtor's equity has lost all value (*In re Central Funding Corp.,* 75 F. [2d] 256) and though the Debtor has conveyed away its equity "long before the proceeding was started" (*In re Mortgage Securities Corp.,* 75 F. [2d] 261, 262).

In the instant case, the District Court in confirming the Plans reserved jurisdiction to give such further authorizations or directions with regard to the Plans and the property dealt with by the Plans as might be necessary to carry out and consummate the Plans (R. 372-373). It thereafter, by various orders, provided a method to make effective, consummate and carry out the Plans (R. 378-387). The steps provided for, as we have shown above, were the formation of a New Corporation, an authorization and direction to the Debtor and its 77B Trustees to assign all their right, title and interest in the Trust Fund collateral to the New Corporation, the approval of Modified or Supplemental Trust Agreements, an authorization and direction to petitioner and the other Trustees under the original Trust Agreements to assign, convey and deliver the Trust Fund collateral to the Successor Trustee and, finally, an authorization and direction to the Trustees under the original Trust Agreements to account in the reorganization proceeding for their respective acts and proceedings as Trustees. This authorization and direction to account was contained in the orders approving the Supplemental Trust Agreements (R. 380, 383-384).

It quite plainly appears that these steps were interrelated, orderly and necessary to make effective and carry out the plans. They were taken and provided for in accordance with the plans and the mandate of Section 77B (b) (9) that a plan, within the meaning of the section, "shall provide adequate means for the execution of the plan". Indeed, the order of the District Court taking jurisdiction over these accounts and objections specifically provides that jurisdiction was taken "to make effective, consummate and carry out" the Plans (R. 206).

Manifestly, the superseded Corporate Trustees had both a right and an obligation to account to the reorganization court which had modified the Trust Agreements, appointed a Successor Trustee and provided for the transfers of the Trust Fund collateral to the new Trustee. And the power

of the bankruptcy court to settle the accounts and pass upon the objections thereto was fully provided for by the Bankruptcy Act. Section 77B (b) (10) specifically provided that the Court could enforce an accounting under a trust indenture. Section 77B (b) (9) provided that adequate means for the execution of the plan may include "the satisfaction or modification of liens, indentures, or other similar instruments". Section 77B (h) further provided that upon confirmation of a plan the Court may direct "the trustee of any obligation of the debtor" to make any necessary transfer or conveyance of the property dealt with by the plan. Standing alone, the power to satisfy a trust indenture implies the necessary incidental power to take a complete accounting (Cf. *Glenny* v. *Langdon*, 98 U. S. 20, 25).

And it is manifest that the power to take an accounting would be ineffectual, unless the Court also had the power to pass upon objections to an account.

Chapter X amplified rather than restricted the jurisdiction of a reorganization court over indenture trustees (Secs. 126, 170, 198, 206, 212, 227).

It clearly appears, therefore, that the jurisdiction issue raised by petitioner does not present any important question of bankruptcy law requiring determination by this Court.

CONCLUSION

The petition should be denied.

Respectfully submitted,

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Counsel for Prudence Securities Advisory Group.

Dated: New York, May 19, 1942.

APPENDIX

Rule 23 (1) of the Federal Rules of Civil Procedure:

> "Rule 23 (1). Class Actions. Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is
>
> (1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it;"

Section 195 of the New York Civil Practice Act:

> "Sec. 195. Suing for benefit of others. Where the question is one of a common or general interest of many persons or where the persons who might be made parties are very numerous and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of all."

The Bankruptcy Act as amended by the Act of June 7, 1934 (11 U. S. C. A. Secs. 207 (b) (9), 207 (b) (10), 207 (h)):

> Sec. 77B (b) (9). "A plan of reorganization within the meaning of this section * * * (9) shall provide adequate means for the execution of the plan, which may include the transfer of all or any part of the property of the debtor to another corporation or to other corporations, or the consolidation of the properties of the debtor with those of another corporation, or the merger or consolidation of the debtor into or with another corporation or corporations, or the retention of the property by the debtor, the distribution of assets among creditors or any class thereof, the satisfaction or modification of liens, indentures, or other similar

instruments, the curing or waiver of defaults, extension of maturity dates of outstanding securities, the change in interest rates and other terms of such securities, the amendment of the charter of the debtor, and the issuance of securities of either the debtor or any such corporation or corporations, for cash, or in exchange for existing securities, or in satisfaction of claims or rights, or for other appropriate purposes;"

Sec. 77B (b) (10). "Provided, That the judge shall scrutinize and may disregard any limitations or provisions of any depositary agreements, trust indentures, committee or other authorizations affecting any creditor acting under this section and may enforce an accounting thereunder or restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claims filed by such committee member or agent, to the actual consideration paid therefor."

Sec. 77B (h). "Upon final confirmation of the plan * * * the court may direct the trustee or trustees, or if there be no trustee, the debtor and any mortgagee, the trustee of any obligation of the debtor, and all other proper and necessary parties, to make any such transfer or conveyance, and may direct the debtor to join in any such transfer or conveyance made by the trustee or trustees."

The Bankruptcy Act as amended by the Act of June 22, 1938 (11 U. S. C. A. Secs. 212, 227):

"Sec. 212. The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

"Sec. 227. The court may direct the debtor, its trustee, any mortgagees, indenture trustees, and other necessary parties to execute and deliver or to join in the execution and delivery of such instruments as may be requisite to effect a retention or transfer of property dealt with by a plan which has been confirmed, and to perform such other acts, including the satisfaction of liens, as the court may deem necessary for the consummation of the plan."

(24)

IN THE

Supreme Court of the United States

OCTOBER TERM 1941

No. 1196

IN THE MATTER
of
PRUDENCE-BONDS CORPORATION,
Debtor.

IN THE MATTER
of
The Judicial Settlement of the Account of Proceedings of MANUFACTURERS TRUST COMPANY, as Successor Trustee of Prudence-Bonds, Twelfth Series, under Trust Agreement dated February 1, 1928, between Prudence-Bonds Corporation and Chatham Phenix National Bank and Trust Company, as Trustee.

MANUFACTURERS TRUST COMPANY,
Petitioner,
against
CHARLES H. KELBY and CLIFFORD S. KELSEY,
Trustees of the Debtor;
PRUDENCE-BONDS CORPORATION
(New Corporation);
MARY KEANE, et al.;
GEORGE E. EDDY and
PRUDENCE SECURITIES ADVISORY GROUP.

REPLY BRIEF ON BEHALF OF PETITIONER

CHARLES E. HUGHES, JR.,
DAVID BARNETT,
CURTISS ELY FRANK,
Counsel for Petitioner.

INDEX

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REPLY BRIEF ON BEHALF OF PETITIONER

FIRST: As to the standing of respondents to present claims on behalf of all bondholders as a class.

No New York case cited by the respondents holds contrary to the proposition that, where the trustee or other

fiduciary has not misappropriated a part of the *res* for its own benefit, but has at most been guilty of a breach of its fiduciary duties with respect to the *res*, the resulting right of action is individual and personal to the bondholders who had that status at the time of the alleged breach of trust. The cases chiefly stressed (Brief, pp. 17-19) are: *O'Beirne* v. *Bullis*, 80 Hun 570, aff'd sub nom, *O'Brien* v. *Allegheny & Kinzua R. R. Co.*, 151 N. Y. 372, same case, 2 App. Div. 545, aff'd 158 N. Y. 466, rearg. den. 158 N. Y. 719; and *Zebley* v. *Farmers Loan & Trust Co.*, 139 N. Y. 461. While the *O'Beirne* case was brought by a bondholder on behalf of all other bondholders of a mortgage trust indenture, it was not brought against the mortgage trustee (except as a nominal defendant because of its refusal to bring the action). The real defendants were the promoters and sole stockholders of the mortgagor railroad company which received the proceeds of the bond issue on a representation that such defendants owned or controlled certain timberlands which would be brought under the lien of the mortgage pursuant to the contract made by such defendants. The primary relief demanded was for specific performance, but, since it appeared that the defendants did not own most of the land, this was molded to relief for a money judgment. Since the defendants had received the proceeds of the bond issue for expenditure pursuant to the terms of the contract, the cause of action was more analogous to one for misappropriation than for breach of a fiduciary duty such as is here involved.

The *Zebley* case arose upon demurrer to a complaint. The opinion of the court makes no mention of the point that the plaintiff may have been an assignee of the bonds. The only indication of this is in certain quite unspecific language in the complaint as printed in the record on appeal. The defendant's brief in that case shows that it did not include as one of its contentions the argument that plaintiff was precluded from recovery on that ground (Defendant's brief, p. 4). However that may be, the case is also analogous to one of misappropriation. The complaint alleged that the

mortgage trustee had on mortgage foreclosure bought in the mortgaged real estate and conveyed it to a new corporation for some consideration to the plaintiff unknown. The complaint alleged among other things that the defendant "has wrongfully, and in violation of the trust converted to its own use the share of the property or its proceeds to which the plaintiff is entitled under the trust" (139 N. Y. p. 467). That action was not a representative one but rather a suit by an individual bondholder to recover the proportion of the trust assets applicable to his bonds.

All of the cases upon which respondents rely are, with two exceptions, old cases not related to the line of recent authorities which are determinative here. One of the exceptions is *Matter of People (Lawyers Westchester Mortgage & Title Co.)*, 288 N. Y. 40 (Respondent's Brief, p. 24), which is not in point. That was a proceeding involving, not the enforcement of liability against a trustee or fiduciary for breach of fiduciary duties, but against the guarantor of the mortgage certificates upon its contract of guaranty. The court, casting no doubt upon the authority of *Mittlemann* v. *President, etc. of Manhattan Company,* 248 App. Div. 79, aff'd. 272 N. Y. 632, and *Weil* v. *President and Directors of Manhattan Company,* 275 N. Y. 238, held them inapplicable upon that ground. It has never been contended in the Prudence proceedings that causes of actions upon the Prudence Company's contracts of guaranty did not pass to the assignee of the bonds. The other of the two exceptions, *Matter of 22-52 44th Street, Long Island City,* 176 Misc. 249 (Brief, p. 26), also involved the enforcement of rights upon the contract of guaranty and was distinguished upon that ground in *Emmerich* v. *Central Hanover Bank & Trust Company,* 34 N. Y. S. (2d) 166, the opinion in which appears in the appendix to our brief in support of the petition.

Respondents' emphasis placed upon the contention that petitioner here was the trustee of an express trust, holding legal title, is misplaced. While we contend (Brief in support of petition p. 19, footnote) that, in all substantial respects,

petitioner was no more a trustee than the fiduciaries involved in the Title Guarantee and Trust Company and New York Title & Mortgage Company cases, our chief contention on this question is that under the New York cases it makes no difference whether petitioner was technically a trustee or some other sort of fiduciary. The trustees of the debtor, respondents herein, themselves argued (R. 279), in a brief presented to the Circuit Court of Appeals in 1935:

> "The mortgages which are in the **physical possession* of the appellants as trustees constitute collateral *owned by the Debtor* subject to the lien of the indentures, and are held by the appellants *as security* for the payment of the bonds issued under the indentures. The instruments, labeled 'Trust Indentures,' *are in substance and effect merely mortgages or pledges of the Debtor's property. This is apparent from a mere casual inspection of the indentures.*"

The Circuit Court of Appeals accepted this view, and jurisdiction of the bankruptcy court in the 77B proceedings was predicated upon the Debtor's property rights as owner of the collateral. *In re Prudence-Bonds Corporation,* 77 F. (2d) 328, 330, cert. den. 296 U. S. 584. The only question before the New York Court of Appeals in *Pres., etc., of Manhattan Co.* v. *Prudence Co.,* 266 N. Y. 202, was whether an actionable event of default had occurred which authorized the indenture trustee to take over the servicing and management of the collateral. No question was raised or decided as to whether a trust existed and the court's expression on that subject was sheer dictum. The Circuit Court of Appeals indicated that such was the fact in *In re Prudence Bonds Corporation,* 79 F. (2d) 212, 217.

Respondents have argued that an injustice will be done unless they prevail on the merits. While this is not the place to discuss that contention, which has already been referred to in our brief in support of the petition (footnote p. 24),

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*All italics in quotations in this brief are supplied.

we wish to emphasize that if the decision of the Circuit Court of Appeals below stands, a New York corporate trustee will not only be liable in a class suit in the federal court to all current bondholders for a past breach of trust, but also, under the New York decisions relied on in our brief in support of the petition, will be liable to bondholders who held their bonds at the time of the breach of trust and who prosecute individual claims against the trustee in the New York state courts. See *Hansberry* v. *Lee,* 311 U. S. 32.

SECOND: The statute of limitations.

None of the New York decisions cited by respondents involve corporate trust indentures, except *Zebley* v. *Farmers Loan & Trust Company,* 139 N. Y. 461. That case, besides being earlier than the cases on which we rely, is not in point. It arose on demurrer to a complaint the principal allegations of which have been summarized above. The grounds of the demurrer were: (1) that the complaint did not state facts sufficient to constitute a cause of action; (2) that the court had no jurisdiction of the subject of the action; and (3) that there was a defect of parties (139 N. Y. p. 467). On the first ground defendant contended that the claim was a stale one which a court of equity will not entertain. The Court of Appeals (*id.* pp. 468-469) pointed out that, even where the complaint on its face discloses a cause of action barred by the statute of limitations, the question could not be raised by demurrer but must be raised by answer. The sentence relied upon by respondents (Brief, p. 29) was obviously dictum.

None of the cases cited by us in our point on the statute of limitations is referred to in the answering brief, except *Rhinelander* v. *Farmers Loan & Trust Company,* 172 N. Y. 519, and respondents' attempted distinction, whatever may be thought of its applicability to that case, cannot apply to those other cases (See Brief in support of Petition, pp. 27-30).

Respondents refer (Brief, p. 6) to certain injunction orders, upon which they argue (Footnote, p. 14) that petitioner, having secured injunctions against suits for accounting in the state courts, now says that the state court is the proper forum, but that the six-year statute of limitations "which petitioner says has been running meanwhile, will apply to any objections". This implication is not justified. The Special Master found (R. 464) that:

> "No order of this Court at any time enjoined any action by any holder of Prudence-Bonds, Twelfth Series, against Manufacturers Trust Company for damages sustained by said bondholder by reason of any alleged breach of trust referred to in the objections."

This finding was one of those to which objection was sustained in a blanket ruling by the District Court (R. 502). However, if the injunction orders should be construed to bar individual actions by bondholders for alleged breaches of trust by petitioner, the statute of limitations would of course be tolled during the period of such injunction. If, on the other hand, those injunctions should not be construed as barring such suits, access to the courts has at all times been available to the bondholders. Neither the Special Master, the District Court nor the Circuit Court of Appeals mentioned this contention of respondents in their opinions.

THIRD: Jurisdiction.

There is no new argument in respondents' treatment of the question of jurisdiction which merits reply. Respondents (Brief, p. 32) mistakenly suppose that our contention that any recovery from petitioner would not constitute property of the Debtor is based chiefly upon the fact that the Debtor "was a participant in the wrongful acts objected to". This subject is dealt with fully at page 32 of our brief in support of our petition.

The asserted "acquiescence" by petitioner in the jurisdiction of the bankruptcy court to pass upon the objections to its account is not only immaterial but was limited by the statement of petitioner's counsel at the hearing before the Special Master (R. 296):

> "MR. BARNETT: I admit they [the assignments of mortgages from Debtor to petitioner] were sufficient to pass a title which I call a record title, but under the law of pledges, that the title remains with the pledgor, and I say that rule is the basis of this Court's jurisdiction. If you hold that the title is not in the pledgor, then we have no right to be here anyhow."

In a footnote on page 9, and at page 31 of their brief, respondents refer to the fact that the record on appeal in the case of *Central Hanover Bank and Trust Company, et al.* v. *President, etc., of Manhattan Company, et al.,* 105 F. (2d) 130, while incorporated into the present record by reference (R. 203), has not been filed with this court on the present petition. We believe that, upon this petition for certiorari, the jurisdictional question sufficiently appears from the record in this proceeding and the opinion of the Circuit Court of Appeals at 105 F. (2d) 130, but, in case the court wishes to refer to the record on that former appeal, we are, with this reply brief, filing a copy of that record with the clerk.

Respectfully submitted,

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Dated: New York, May 21, 1942.